C76/3

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

NEWARK PUBLIC LIBRARY

OCT 6 1980

U. S. GOVT. PUBS.
DEPOSITORY 376

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

WASHINGTON, D.C., JANUARY 31 AND FEBRUARY 1, 7, 8,
12, 27, AND 28, 1980

Printed for the use of the Committee on Small Business

Y4.Sm1:

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

WASHINGTON, D.C., JANUARY 31 AND FEBRUARY 1, 7, 8,
12, 27, AND 28, 1980

Printed for the use of the Committee on Small Business

60-769 O

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1980

COMMITTEE ON SMALL BUSINESS

NEAL SMITH, Iowa, *Chairman*

TOM STEED, Oklahoma
JOHN D. DINGELL, Michigan
JAMES C. CORMAN, California
JOSEPH P. ADDABBO, New York
FERNAND J. ST GERMAIN, Rhode Island
PARREN J. MITCHELL, Maryland
HENRY B. GONZALEZ, Texas
JAMES M. HANLEY, New York
JOHN J. LaFALCE, New York
BERKLEY BEDELL, Iowa
FREDERICK W. RICHMOND, New York
ALVIN BALDUS, Wisconsin
RICHARD NOLAN, Minnesota
RICHARD H. ICHORD, Missouri
HENRY J. NOWAK, New York
THOMAS A. LUKEN, Ohio
ANDY IRELAND, Florida
DALE E. KILDEE, Michigan
IKE SKELTON, Missouri
BILLY LEE EVANS, Georgia
DOUG BARNARD, Jr., Georgia
CLAUDE LEACH, Louisiana
TONY P. HALL, Ohio
CHARLES W. STENHOLM, Texas
GLADYS NOON SPELLMAN, Maryland

JOSEPH M. McDADE, Pennsylvania
SILVIO O. CONTE, Massachusetts
J. WILLIAM STANTON, Ohio
WILLIAM S. BROOMFIELD, Michigan
TIM LEE CARTER, Kentucky
DAN QUAYLE, Indiana
DAN MARRIOTT, Utah
TOBY ROTH, Wisconsin
LYLE WILLIAMS, Ohio
OLYMPIA J. SNOWE, Maine
DOUGLAS K. BEREUTER, Nebraska
ED BETHUNE, Arkansas
ARLEN ERDAHL, Minnesota
THOMAS J. TAUKE, Iowa
JOHN EDWARD PORTER, Illinois

Thomas G. Powers, *General Counsel*
Lois Liberty, *Publications Specialist*
Raymond S. Wittig, *Minority Counsel*

Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business

BERKLEY BEDELL, Iowa, *Chairman*

JAMES M. HANLEY, New York
HENRY B. GONZALEZ, Texas
RICHARD H. ICHORD, Missouri
TONY P. HALL, Ohio
IKE SKELTON, Missouri

DAN QUAYLE, Indiana
OLYMPIA J. SNOWE, Maine
THOMAS J. TAUKE, Iowa

Marc H. Rosenberg, *Subcommittee Professional Staff Member*
Mark J. Levine, *Subcommittee Staff Assistant*
Karen Davis Hoppe, *Minority Subcommittee Professional Staff Member*

CONTENTS

Hearings held on— Page

January 31, 1980 1
February 1, 1980 49
February 7, 1980 91
February 8, 1980 139
February 12, 1980 191
February 27, 1980 255
February 28, 1980 295
Bedell, Hon. Berkley, chairman, Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business: Opening statements 1, 49, 91, 139, 191, 255, 295

Panels consisting of—

Economists: Barry Bluestone and Bennett Harrison 192
Economists: Yale Brozen, Robert Hessen, and George Benston 236
Federal antitrust enforcement officials: Alfred Dougherty, Jr., and Sanford Litvack 92
Representatives of Bates Manufacturing Co., Lewiston, Maine: Raymond St. Pierre and John C. Turner 30
Representatives of Colonial Cooperative Press, Inc., Clinton, Mass.: John Saulnier, Joseph Casasanto, and Steve Dawson 16
Representatives from Hopedale, Mass.: Bernard Stock, Robert Phillips, Benjamin Phillips, and Dan Prouty 3
Representing Progressive Alliance: Barbara E. Richards and Daniel J. Marschall 319
Small Business Trade Association representatives: John Motley III, Tom Mauro, and Edison Zayas 298
Sociologists: Robert Stern and Kenneth Root 213
Witnesses from the Department of Labor: William Batt, Robert Anderson, and Marvin Fooks 172
Witnesses from Youngstown, Ohio: Ed Kelly, John Greenman, Rev. Charles Rawlings, and Staughton Lynd 57

Testimony of—

Anderson, Robert, Administrator, Office of Comprehensive Employment Development, Department of Labor 176
Baker, John R., president, American Safety Razor Co., Staunton, Va.; accompanied by Arthur J. Gajarsa, attorney at law 50
Batt, William, executive secretary, Commerce-Labor Action Committee 175
Benston, George, University of Rochester, Rochester, N.Y 244
Birch, David L., Massachusetts Institute of Technology, Cambridge, Mass . 229
Bluestone, Barry, associate professor of economics, Boston College, Chestnut Hill, Mass 203
Brozen, Yale, University of Chicago, Chicago, Ill 237
Butler, Hon. M. Caldwell, a Representative in Congress from the State of Virginia 49
Casasanto, Joseph, Colonial Cooperative Press, Inc., Clinton, Mass 20
Cutler, Lynn G., chairperson, Black Hawk County Economic Development Committee, Inc., Black Hawk County, Iowa 140
Dawson, Steven, Industrial Cooperative Association, Cambridge, Mass 28
Dougherty, Alfred F., Jr., Director, Bureau of Competition, Federal Trade Commission; accompanied by Kenneth M. Davidson, Deputy Assistant Director 100
Duckworth, Robert P., Executive Assistant to the Deputy Assistant Secretary for Urban Policy, Department of Housing and Urban Development 159
Fooks, Marvin, Director, Office of Trade Assistance, International Labor Affairs Bureau, Department of Labor 172

Testimony of—Continued

Page
Greenman, John F., urban affairs editor, Tribune Chronicle, Warren, Ohio 68
Hall, Robert T., Assistant Secretary for Economic Development, Department of Commerce; accompanied by Harold W. Williams, Deputy Assistant Secretary for Economic Development, George Karras, Deputy Assistant Secretary for Operations, EDA, and Edward M. Levin, Jr., Chief Counsel, EDA 256
Harrison, Bennett, associate professor of economics and urban studies, Department of Urban Studies and Planning, Massachusetts Institute of Technology, Cambridge, Mass 192
Hessen, Robert, Hoover Institute of War, Revolution, and Peace, Stanford University, Palo Alto, Calif 239
Kelly, Ed, research director, Ohio Public Interest Campaign 59
Litvack, Sanford M., Special Assistant to Attorney General, Department of Justice 93
Lynd, Staughton, general counsel, Ecumenical Coalition, Mahoning Valley Council, Tri-State Conference on the Impact of Steel 63
Marschall, Daniel J., staff director, Citizen Action, and in behalf of the Progressive Alliance 328
Mauro, Thomas A., National Small Business Association 308
Motley, John J., III, deputy director of legislative affairs, National Federation of Independent Business; accompanied by Edison R. Zayas, economist 299
Phillips, Robert S., town clerk and town counsel, Hopedale, Mass 6
Rawlings, Rev. Charles W., officer for Church and Society, Episcopal Diocese of Ohio 71
Richards, Barbara E., executive director, Community-Labor Alliance, New Haven, Conn 319
Root, Kenneth A., sociologist, Luther College, Decorah, Iowa 218
Saulnier, John, Colonial Cooperative Press, Inc., Clinton, Mass 17
Stern, Robert, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y 213
Stewart, Milton D., Chief Counsel for Advocacy, Small Business Administration 147
Stock, Bernard, administrative coordinator to the board of selectmen, Town of Hopedale, Mass 4
St. Pierre, Raymond, vice president and treasurer, Bates Fabrics, Inc 31
Turner, John C., executive director, Lewiston Economic Growth Council, Lewiston, Maine 34
Wheat, James C., Jr., chairman of the board, Wheat First Securities, Inc., Richmond, Va 333
Williams, Harold M., Chairman, Securities and Exchange Commission 279

Additional material supplied for the hearing record—

Birch, David L., Massachusetts Institute of Technology, Cambridge, Mass.: Prepared statement 231
Bluestone, Barry, associate professor of economics, Boston College, Chestnut Hill, Mass: Start-up and closings of private business establishments—Table 207
Dougherty, Alfred F., Jr., Director, Bureau of Competition, Federal Trade Commission:
  Prepared statement 105
  Testimony correction regarding BIC Pen Corp 114
Duckworth, Robert P., Executive Assistant to the Deputy Assistant Secretary for Urban Policy, HUD:
  Federal coordination in the Youngstown steel situation 171
  Prepared statement 162
  Use of urban development action grant funds in Akron, Ohio 170
Fooks, Marvin, Director, Office of Trade Assistance, International Labor Affairs Bureau, Department of Labor: Trends in nonagricultural establishment employment 184
Greenman, John F., urban affairs editor, Tribune Chronicle, Warren, Ohio: Prepared statement 70
Hall, Robert T., Assistant Secretary for Economic Development, Department of Commerce: Prepared statement 259
Harrison, Bennett, associate professor of economics and urban studies, Department of Urban Studies and Planning, Massachusetts Institute of Technology, Cambridge, Mass.: Investment and disinvestment in the Campbell Works of the Youngstown Sheet and Tube Co., 1960–75 199

Additional material supplied for the hearing record—Continued

Page
- Hessen, Robert, Hoover Institute of War, Revolution, and Peace, Stanford University, Palo Alto, Calif.: Prepared statement 242
- Kelly, Edward, research director, Ohio Public Interest Campaign 62
- Kostmayer, Hon. Peter H., a Representative in Congress from the State of Pennsylvania: Statement 295
- Litvack, Sanford M., Special Assistant to Attorney General, Department of Justice:
  - Prepared statement 96
  - Operation of the Newspaper Preservation Act of 1970 132
- Lynd, Staughton, general counsel, Ecumenical Coalition, Mahoning Valley Council, Tri-State Conference on the Impact of Steel: Prepared statement 66
- Metzenbaum, Howard M., Senator in Congress from the State of Ohio: Prepared statement 57
- Motley, John J., III, deputy director of legislative affairs, National Federation of Independent Business: Table—Average annual percent growth of U.S. establishments by size and legal status, 1969-72 and 1972-74 301
- Root, Kenneth A., sociologist, Luther College, Decorah, Iowa: Prepared statement 221
- Rothwell, Thomas A., and Thomas A. Mauro, on behalf of National Small Business Association: Prepared statement 309
- Stern, Robert N., New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y.: Prepared statement 216
- Stewart, Milton D., Chief Counsel for Advocacy, Small Business Administration: Prepared statement 150
- Wheat, James C., Jr., chairman of the board, Wheat First Securities, Inc., Richmond, Va.: Prepared statement 334
- Williams, Harold M., Chairman, Securities and Exchange Commission: Prepared statement 285

APPENDICES

- A.—Companies discussed in the hearings 343
- B.—Abatement agreement between Rockwell International Corp. and the town of Hopedale, Mass 345
- C.—Letter from Senator Howard Metzenbaum to Chairman Bedell; re the liquidation of Colonial Press 352
- D.—Staff memo to Chairman Bedell; re the effects of changes in the copyright laws on the book publishing industry 363
- E.—Material submitted by Hon. Olympia J. Snowe; re the Bates Manufacturing ESOP 365
- F.—Letter to Chairman Bedell from Hon. M. Caldwell Butler; re American Safety Razor Co 367
- G.—Sworn affidavit of Clifford Goldsmith, Philip Morris; re Philip Morris' intention to liquidate American Safety Razor Co 429
- H.—Staff summary of Department of Justice memo; re Youngstown Sheet and Tube-Lykes Corp. merger 436
- I.—Letter submitted by Reverend Rawlings 439
- J.—Statement of United States Steel's David Roderick on employee ownership possibilities at closed United States Steel plants 440
- K.—Remarks by Hon. Berkley Bedell before the Senate Select Committee on Small Business, February 5, 1980 442
- L.—Material supplied by Hon. Lyle Williams; re Youngstown Sheet and Tube 447
- M.—Letter from Hon. Alvin Baldus; re Jon C. Udell's study of mergers in Wisconsin 470
- N.—Additional material supplied by the FTC; re conglomerate mergers 483
  - Exhibit 1.—Statement of the FTC on conglomerate merger legislation proposals 485
  - Exhibit 2.—Mr. Alfred Dougherty's remarks about small business in the American economy 490
  - Exhibit 3.—Statement of Mr. Alfred Dougherty on the acquisition of Federal Glass Co 515
- O.—Attachments to testimony of Lynn Cutler, Rath Meatpacking, Waterloo, Iowa 540
- P.—Material supplied by Hon. Tom Tauke: David Barkley on plant ownership characteristics in Iowa 589
- Q.—Robert Stern and Howard Aldrich—Presentation to the FTC conference on Firm Size, Market Power and Social Performance 598

READEX
FICHE

Page

R.—Material submitted by Ken Root; re study of the Mason City, Iowa, Armour plant closing 628

S.—Material submitted by Tom Mauro, representing the National Small Business Association: "The Job Generation Process" by David Birch 648

T.—Material submitted by Hon. James Hanley; re General Motors and anticompetitive practices 672

U.—Material submitted by Robert Hall, EDA: EDA consideration of loan guarantee assistance to Youngstown, Ohio 677

V.—Ecumenical Coalition response to EDA 696

W.—Material obtained from EDA through the Freedom of Information Act request of the Ecumenical Coalition 697

X.—Additional material re EDA loan guarantee assistance to Wisconsin Steel Corp 704

Y.—Material entered into the hearing record by SEC Chairman Harold M. Williams: Speech before the Securities Regulation Institute, January 17, 1980 721

Z.—Material submitted by SEC Chairman Harold M. Williams 748

AA.—Material submitted by SEC Chairman Williams: Prof. D. V. Austin's study of tender offers in 1978-79 792

BB.—Article by Samuel Smith: "Advertising and the Conglomerates" 824

CC.—Department of Justice study: Conglomerate mergers, small business, and the scope of existing antimerger statutes 838

DD.—Statement submitted by William C. Norris, chairman and CEO, Control Data Corp 889

EE.—Statement submitted by Prof. William F. Whyte, Cornell University 920

FF.—Statement from the Midwest regional office of the U.S. Commission on Civil Rights 954

GG.—Statement submitted by Kenneth C. Wagner, Mississippi Research and Development Center 967

HH.—Articles by D. C. Mueller:
  Exhibit 1.—"The Effects of Conglomerate Mergers" 973
  Exhibit 2.—"The Case Against the Conglomerate Mergers" 990

II.—Article by David Kotz: "The Significance of Bank Control Over Large Corporations" 1029

JJ.—Material submitted by the National Association of Small Business Investment Companies 1049

KK.—Farmers Home Administration report on the business industrial loan program 1060

LL.—Material submitted by Hon. Lawrence Coughlin: Articles from the Philadelphia Bulletin 1084

MM.—Washington Post series on conglomerate mergers 1091

NN.—Canada's Foreign Investment Review Act 1101

OO.—Statement of the Business Roundtable on conglomerate mergers 1104

PP.—Statement of the Chamber of Commerce on conglomerate mergers 1114

QQ.—Bibliography on effects of mergers on local communities, compiled by Gwenell Bass, Congressional Research Service 1176

RR.—Bibliography on plant shutdowns, closures, and moves, compiled by Kenneth Root, Ph. D 1195

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

THURSDAY, JANUARY 31, 1980

House of Representatives, Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business of the Committee on Small Business,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2359-A, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

Mr. **Bedell**. The Small Business Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business will come to order.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. **Bedell**. This is the first of 7 days of hearings of the Antitrust Subcommittee to explore the subject of conglomerate mergers. Our particular interest in these hearings is their effects on small business and local communities.

As far as we can tell, there has not been much of an effort to determine what the effects are upon communities where mergers and acquisitions of major size have taken place.

These are not legislative hearings. Rather, it is our purpose to conduct a careful and objective study of a phenomenon that is causing significant changes in the nature of our American society. In the 1960's and 1970's we saw a remarkable increase in the concentration of ownership of American business assets. Progressively larger portions of the American economy have come under the control of fewer and fewer people. The most noteworthy development has been the increased incidence of conglomerate mergers or acquisitions, the joining of companies that are in diverse or unrelated fields.

We have on the books a variety of antitrust laws governing mergers of companies in similar lines of business, but these conglomerate mergers basically occur outside the current regulatory system. Some congressional attention has been focused on conglomerate mergers in the past, but the emphasis has been on macroeconomics, the impact on the national economy, or the impact on whole industries. Our interests here, however, are on microeconomics, the impact the merger has on the local community.

Today and tomorrow, we will be looking at case studies of companies that were either acquired or divested by conglomerates. We will hear from company executives, labor union representatives, and community leaders, among others. Next week we will hear testimony from the top antitrust officials at the Justice Department and the Federal Trade Commission. Then we will talk with representatives of a variety of other Federal and local agencies that become involved in areas that are affected by mergers. Later, we have scheduled hearings with an extensive list of economists and academic experts. We will have a day of testimony from representatives of many different interest groups.

One point I want to stress at this time is that every effort has been made to make these hearings as objective as possible. We have tried to contact all interest groups to see that they would have representatives before our hearings so that we could look at both the positive and negative aspects of conglomerate mergers. We come to these hearings not trying to prove a point but trying to get information. Unfortunately, we have been disappointed in the fact that we have been unable to get some of the various groups to present their viewpoint. If these hearings seem to be one sided, it is not because of a lack of effort by the staff of the subcommittee. We have contacted all those organizations representing big business: the Business Roundtable, the National Association of Manufacturers, the U.S. Chamber of Commerce, urging them to bring witnesses that could show to us the benefit that might at times occur through such mergers and acquisitions. Unfortunately, those efforts have been a disappointment to us.

I would say at this time that we would urge those organizations to come forward with witnesses if they have them available because we want these hearings to be as fair, open, and objective as possible. But it is very difficult to consider information if no one will appear before our committee. Some of them imply that it would not be an objective hearing. I assure you that the members of this subcommittee are anxious to hear all viewpoints. We are here to learn rather than prove any points.

Having said this, I also want to state that we do have an excellent list of witnesses who will testify today and in the upcoming hearings. These people have come at their own expense and have taken time to travel to Washington to speak to us. They represent a diversity of viewpoints and a wealth of information. We appreciate very much you people being here, as well as the witnesses that will follow in these hearings.

Congressman Hanley, do you have a statement to make?

Mr. Hanley. Thank you, Mr. Chairman. I do not have a statement. I simply want to commend you for the initiative that you have taken, for your diligence in scheduling this set of hearings on a subject matter so important to the American small business community. I commend you and look forward to the testimony that this committee will enjoy resulting from the fine set of witnesses that you have assembled. Thank you.

Mr. Bedell. I am advised by minority counsel that the Business Roundtable, Chamber of Commerce, and National Association of Manufacturers are sending an economist to testify. We are appreciative of that. The fact is that they were contacted many times, as I understand from talking to the majority staff, and were asked to send us witnesses of case studies of mergers and acquisitions that had been beneficial. There was hope at one time that would occur. Then those witnesses indicated that they would not appear.

The purpose of that statement is to let those people know that, if they want to be heard more than simply sending an economist, we would welcome that opportunity. The purpose of our subcommittee hearings is for us to learn. We cannot learn unless people come before us and let us know their viewpoint.

I do not want to make a further issue of it, but I did want to make that point.

Mrs. Snowe, do you have a statement that you would like to make at this time?

Mrs. SNOWE. Mr. Chairman, I would like to thank you very much for having these hearings this morning. As I understand, we will be having a series of hearings regarding this subject, which I consider a very important subject. So, I am looking forward to the testimony this morning and the beginning of an examination on a very important subject coming before the Small Business Committee. Thank you.

Mr. BEDELL. I should say this before we go too far. I had a commitment that I have to keep at 10 o'clock. If Mr. Hanley can stay here to chair the meeting for 10 minutes, we will continue; if not, it will be necessary for us to call a 10-minute recess at 10 o'clock.

PANEL CONSISTING OF REPRESENTATIVES FROM HOPEDALE, MASS.: BERNARD STOCK, ROBERT PHILLIPS, BENJAMIN PHILLIPS, AND DAN PROUTY

Mr. BEDELL. We have a practice in this subcommittee of swearing our witnesses. Would the witnesses please stand?

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Mr. ROBERT PHILLIPS. I do.

Mr. STOCK. I do.

Mr. PROUTY. I do.

Mr. BEN PHILLIPS. I do.

Mr. BEDELL. How do the witnesses plan to proceed in terms of order?

Mr. STOCK. Mr. Chairman, I think I will begin by reading the testimony. At the conclusion of what I have here, I would like to let our town counsel, Robert Phillips, go through with you a major issue that affected the town as a result of the closing of Rockwell International Draper Division. We are prepared to keep it as short as possible so that we can get into a dialog with you as to some of the more important issues that happened.

Mr. BEDELL. Is Ben Phillips here also?

Mr. STOCK. Ben Phillips is to my extreme left. And to my immediate left is a member who was invited by your staff yesterday to attend with us this morning; his name is Dan Prouty. Mr. Prouty is the manager of a group known as Hopedale Realty Trust. They have just purchased the building from Rockwell International. I think you will find that he is a rather unique individual because he spent quite a bit of his time liquidating companies.

Mr. BEDELL. Do you want to proceed then, Mr. Stock?

TESTIMONY OF BERNARD STOCK, ADMINISTRATIVE COORDINATOR TO THE BOARD OF SELECTMEN, TOWN OF HOPEDALE, MASS.

Mr. STOCK. Thank you, Mr. Chairman and members of the subcommittee.

My name is Bernard Stock. I serve as the administrative coordinator to the board of selectmen of Hopedale, Mass. With me is attorney Robert S. Phillips, Hopedale's town clerk and town counsel; and Benjamin Phillips, who holds numerous elected and appointed positions and had over 45 years of employment to the Draper Co. and Rockwell International.

As long as I am sworn to oath, the second paragraph of my written statement is not quite true. We arrived yesterday and found out that the librarian put a film of Zulu in there instead of a film about the town of Hopedale. We really did not think it would be beneficial to the subcommittee.

The effects of Draper on this town can still be seen in our government, housing, landscape, and way of life. Until 1967, this town lived with a silent, yet paternalistic, partner in a relationship that we took for granted. But our memory of the way things used to be with Draper is the driving force behind our efforts to develop a new business relationship with firms that consider Hopedale a partner in business.

On March 1, 1967, the headlines of the Milford Daily News announced: "Big Firm Makes Bid To Control Draper's—Rockwell Standard Offers $30 Per Share." With talk of a projected decline in loom sales, workers and local residents must have sensed some form of secureness from the announcement. Surely, a corporation of Rockwell's size and diversification could provide the technological and financial support needed to insure job security for workers and protect a significant tax base for the community.

What transpired after this announcement within the system of corporate chess is most interesting. Draper management urged its stockholders on March 3, only 2 days later, to stand pat. Only 11 days later, Draper directors urged a merger with Indian Head, Inc., of New York City, a specialty textile firm. At approximately the same time, Rockwell was attempting to merge with North American Aviation of El Segundo, Calif. On March 27, 1967, a 3-week period, Draper and Rockwell officials approved in principle a merger offer.

In reviewing the history of the merger, one point seems clear yet unsubstantiated. Draper management wanted to retain control following the merger. Rockwell President Willard F. Rockwell, Jr., at a meeting in Boston on March 30, 1967, stated, "A fine management team" would continue after the consummation. In a statement to Draper workers, Mr. Rockwell stated: "Our corporate policy places full operating responsibility on the management of the various divisions." He was referring to the Draper divisions. "The merger will not alter this policy." He added: "As a result of this merger, we feel we have more than just the physical assets of well-known and respected companies. We are counting on the skill of our people and their continued loyalty and cooperation, qualities which far outweigh the importance of land, buildings, and equipment." Draper stockholders voted the merger on June 27, 1967.

Contrary to President Rockwell's remarks, Draper management was soon replaced with Rockwell executives who failed to comprehend the workings of a textile business. More than seven executives passed through the revolving door of the plant manager's office during the troubled 13 years of Rockwell in Hopedale.

Rockwell executives continually pointed to foreign competition as the main source of decline in the textile business. But governmental regulatory agencies also played a role in the Rockwell decline.

Since 1968 the town of Hopedale and Rockwell have attempted to receive State and Federal approval of a new wastewater plant. The Draper Co. built a sewage treatment plant in the early thirties as part of—it was pretty much their position in the town to provide as many benefits to the residents of the town because it was those residents that worked in the company. Wages were very low for Draper workers. As the movie would have pointed out, massive—we think they are massive—homes were built for Draper employees. They were tudor designed houses with six and seven rooms in them. And this was the typical company house. Rent was initially started at $2.10 a week. When electricity was put in, it went to $2.20 a week. Gas was later put in, and they went to $2.30 a week. So, the benefits that were provided enabled Draper workers to work for very low wages. But the housing that was built by the Draper family was recognized in both Paris at a world's fair and St. Louis at a world's fair when they received gold metal awards. It is an extremely unique and attractive New England textile community.

While the town continued to operate a treatment plant once built by Draper and given to the town by Rockwell, government bureaucracy leads us into the 1980's with no positive sign of construction.

The mainstay of any textile manufacturing business is its foundries. Yet, both foundries were forced to close due to air quality standards and electric costs inflated by fuel charges. Draper Looms also failed to pass OSHA sound regulations. As one Rockwell executive put it: "After you environmentalize and OSHA-fy this business, you're broke." It is a fact of life that many a textbook environmentalist should learn.

The end came and was accepted. For almost 5 years, we witnessed layoff after layoff. Families with generations in Hopedale and with Draper were uprooted. Steam heat to public buildings was terminated. Executive offices closed and personnel moved south. Company-owned facilities such as the Grafton and Upton Railroad, the Hopedale Coal and Ice Co., Hopedale Airport, and other buildings were sold, in many instances at values far less than generally accepted in real estate trades. Sixteen hundred acres of land were placed up for sale, and an application for an abatement was filed by Rockwell officials to further reduce their financial commitment to the town.

The entire ordeal has left this town with mixed emotions. Through negotiations, we have been able to secure ownership of buildings and land vital to a way of life we have known and wish to retain for our children. We hope today closes the final chapter on what happened to Hopedale as a result of the Rockwell-Draper merger.

Mr. Hanley, if you will, at this time I would like to allow our town counsel to get into, to the extent that you want, an abatement that was filed by Rockwell International. He can explain what an abatement is and at the same time give to you the significance that it had on the town.

Mr. **Hanley**. Fine. If the gentleman would proceed, we will hear from him at this time.

TESTIMONY OF ROBERT S. PHILLIPS, TOWN CLERK AND TOWN COUNSEL, HOPEDALE, MASS.

Mr. **Robert Phillips**. My name is Robert S. Phillips, and I am an attorney. I am the town attorney at an annual retainer of $1,800. That's how I get the title.

In 1978, Rockwell Corp. filed a petition with the local board of assessors, seeking a reduction in the assessed tax values placed upon their plant, main office, and various pieces of property. The application was denied by the board of assessors. Then Rockwell appealed to the Massachusetts Appellate Tax Board, which is a process we have to resolve the matter. [See Appendix B.]

Meanwhile, the assessors continued to negotiate and deal directly with the Rockwell people in trying to resolve this particular problem.

I have on page 2, I think, some data that I gave you a breakdown of the figures that we were talking about. The 1977 assessed value of the Rockwell properties was $13.7 million, of which the plant was over $9 million, the west foundry that Mr. Stock referred to was over $2 million, and the rest was improved and vacant land.

It was a very difficult proposition to deal with because of the very involved legal problems that would arise. You need expert witnesses. You would have had all kinds of hearings. So, the assessors attempted to negotiate with the Rockwell tax people. They came up with a 3-year program, which is outlined on pages 2 and 3.

In summary, in 3 years, starting with January 1, 1978, and ending in January 1, 1980—because January 1 is our assessing date—the value of those properties dropped from $13.7 million to $8.3 million, which is a loss of $5 million in tax valuation and over $300,000 in tax revenue. That means that $300,000 in tax revenue has now been shifted over to the residential homeowner and to the small storeowner.

This poses a significant problem in our town finances since practically 70 percent of our local revenues are raised by real estate taxation. That means that, unless we can take this enormous plant and complex and get new businesses in there and keep the thing viable and operative, we are going to suffer a very severe economic loss. The town would almost be eligible for a chapter 13 bankruptcy reorganization or something like that. We got to keep the thing going.

One reason we are here is to point out the effect of these mergers upon the town itself. This is what happened to Hopedale. We are in a very, very difficult financial bind.

Mr. **Hanley**. Was it the intent of you gentlemen to testify as a panel, or does that complete the testimony?

Mr. **Stock**. That completes the testimony. We would like to enter into some dialog, if you would wish.

Mr. **Hanley**. As I hear you out and I draw from your testimony, the question in my mind is, is the dilemma you are in actually the result of the conglomerate takeover; or is it resultant from, as you have described, the effects of Government regulations, OSHA, environmental requirements and such which, of course, would have applied regardless of who had retained ownership of the industry?

Your testimony does not suggest any specifics resultant from the corporate takeover, the Rockwell takeover. You relate to causes such as Government regulations. You relate to the environmental regulations. You relate to OSHA. Of course, all of these would have prevailed regardless of who owned the industry. There is not anything specific in your testimony that pointedly says that, by virtue of the conglomerate takeover, for these reasons we find ourselves in this dilemma.

Could you separate the two? We understand. We are thoroughly aware of the problem that many industries have resultant from certain Government regulations, the environmental standards, and OSHA requirements. We understand all of this, and we are quite well acquainted with it. So, if we could just separate that.

Then, if you would, deal with some of the problems that actually resulted from the Rockwell takeover which would not have existed had management and ownership remained the same. You did allude to turnover from the standpoint of managers, I believe, But, if you could tell us some of the practices of Rockwell that served to the detriment of the operation, it would be helpful to the committee.

Mr. **Stock**. One of the very first things that Rockwell did when it came in was to significantly reduce its research and development staff. The Draper loom—I believe Bob made the statement yesterday to the staff—at one time every towel in this country was woven on a Draper loom. The Diamond D trademark that was on that loom was as significant as the Cadillac trademark in the automobile business.

The Rockwell people, when they came in and made the substantial cuts in that division, felt that they had a frontline loom that could stay competitive for years. That loom was never competitive. What happened was, without that research and development team, a group that had been entirely responsible for the Draper Co., profits and for their continued improvement in the textile business was simply gone.

Another thing they did was to significantly reduce and later entirely terminate the maintenance staff that was in the building. The building was absolutely spotless under the Draper family. Today it has broken windows that are covered up with metal sheeting. It has not been painted in years. The bricks are dirty. The entire place, you cannot go in there yourself without coming out with soot and dust and everything all over.

The communication between town officials and between Rockwell executives ended around 1977. Rockwell International made a decision to close its main office which housed its executives and take the vice president and staff to Pittsburgh. We no longer had someone in the town of Hopedale that could make a decision on company-town-related problems. We began dealing with lawyers from

Pittsburgh and top executives from Pittsburgh. The company-town relationship was gone.

The abatement that Attorney Phillips referred to was negotiated by his son, a 25-year-old accountant, his second year as an assessor, with high-priced lawyers from Pittsburgh. Surely, I think some of these things are not what we would have found under the Draper family. It was an entirely different way of life with the Draper Co.

Back in the recession, there were 24,000 people working in that building—2,400; I stand corrected. There were 2,400 people in that building, and that was almost maximum employment. They had a way of surviving the peaks and valleys; Rockwell did not.

Mr. HANLEY. Do I understand you as saying that Rockwell, during the course of its ownership, failed to make any capital investment at all in the physical facility? Is that correct?

Mr. STOCK. That is correct.

Mr. HANLEY. Of course, in this type of activity, from time to time there are allegations that corporations will move in and take over an industry not really for the purpose of making that industry spin and perpetuate it but, opposed to that, perhaps enjoy tax benefits, looking upon the overture as a tax-loss venture. Was there any indication that this might have been the case in the Draper takeover?

Mr. ROBERT PHILLIPS. I personally am not connected with the Draper or Rockwell corporation. All I know is from outside observation and talking to people who were there. It appeared, No. 1, that they accomplished this transaction by a stock exchange. They exchanged Draper stock for Rockwell stock, which I understood was a tax-free transfer. Draper people did not have the problem of capital gains on the stock that they had held for many generations.

My understanding was that Draper Corp. had no debt of any kind, no mortgages, very little liabilities, and had quite a bit of cash. The amount of cash had been talked about as between $30 to $40 million. Actually, I do not know—unless you had a treasurer here or somebody who had the time to get the information.

It would appear it was a very lucrative transfer because they picked up all of these assets. Draper Corp. also was a very large landowner in upstate New York. They owned hundreds of thousands of acres of land that they originally bought to use for wooden bobbins and things like that. I understand all this land has been sold.

They owned the largest undivided piece of land in New Hampshire. It was in one ownership with a lake. That was sold soon after the takeover for recreation development.

So, just from an outside observation, it appeared to be a systematic disposal of assests, physical and otherwise. There was very little being put back into the operation.

Mr. HANLEY. Thank you. Mrs. Snowe?

Mrs. SNOWE. Mr. Stock, were you the town administrator when this conglomerate merger took place?

Mr. STOCK. In 1967 I was in Saigon.

Mrs. SNOWE. In your opinion, based on what you know on the conglomerate merger, did Rockwell International have any intentions of retaining Draper Looms, as it was, maintaining the status quo?

Mr. Stock. Maybe I should clarify your initial question. I have lived in Hopedale all my life. My father spent 43 years in that building. We grew up with Draper. They provided our schools. They provided our recreation. They provided every need that we had. So, I think, from a Draper standpoint, we know what they have done for us.

In answer to your question, in the 13 years that Rockwell was there, I do not think at any time we ever felt that corporation had anything at heart as far as we were concerned.

If I can pick up on a point that Bob was getting at. When they bought the corporation, they bought the town because Draper's was the town. They bought 1,600 acres of land. They bought a railroad. They bought an airport. They bought exclusive estates. They bought holdings that were not traditional to your normal—they bought a sewage treatment plant. They found out recently that they are owners of—unfortunately, they are filled—eight grave lots over in the town cemetery. There is a host of other things.

They have never had any desire to retain them. They are all being sold off. We have not had, I don't think, more than 12 houses built in the town of Hopedale in the last 6 or 7 years. Yet, our planning board is now faced with an 89-house-lot subdivision because of land that they sold. We have some tremendous problems as a result of their leaving.

Mrs. Snowe. At the time of the merger, agreements were made with the community of Hopedale such as purchasing a fire station, the treatment plant, and whatever else. Was that part of the agreement?

Mr. Stock. That was just part of their purchase agreement with Draper. The Draper Co. owned and operated the sewage treatment plant.

Mrs. Snowe. They sold it to Rockwell?

Mr. Stock. It was sold, and when it was sold it simply went with the company.

Mrs. Snowe. Then, after that point, after Rockwell purchased Draper Looms, they then in turn went to the town of Hopedale and asked if they would be interested in purchasing the fire station, the treatment plant, whatever else?

Mr. Stock. We owned the fire station. It was the treatment plant that was the problem because it did not meet with the State water pollution requirements. They received a letter saying that they were going to be fined so many thousands of dollars a day if they did not begin to take action to operate the treatment plant.

Mrs. Snowe. So, you feel the town was compelled to purchase the treatment plant so that you could upgrade it to meet Federal standards?

Mr. Stock. We felt that, because of the taxes that they were paying in the town, that it was at least our civic responsibility to take on that responsibility. We as a municipality could become eligible for Federal and State funding. They, as a private industry, could not. So, it was quite easy for us to sit down and negotiate a deal on that particular issue.

Mrs. Snowe. Were there any other kinds of transactions that took place as a result, the town feeling compelled to buy other things from Rockwell to alleviate their financial burden and also to encourage them to stay?

Mr. **Stock**. I don't know that after a while we really wanted to encourage them to stay. You know, nothing was going back in the business. There was never really an upswing in employment. There was never any improvement in the physical appearance of the plant.

We continually saw changes in managers, never managers from within the Draper family or from within the system, someone that had developed from within the loom business. They were always people from General Electric or from the space segment of Rockwell International. It was simply a matter of coming in and using test and design standards and cutting and cutting. When they could cut no more, they would bring someone new in.

Mrs. **Snowe**. Did you approach Rockwell International, or did the town manager approach Rockwell International and convey your sentiments and concerns? Did you have discussions?

Mr. **Stock**. The local government expressed concerns on many occasions. The newspaper on occasion would take them to task over what was happening in the facility.

When you have a company that is so closely knit with families that have from generation to generation worked in the building and things begin to change under a new company, I think stories get started very quickly. The newspaper was not too highly commendable to Rockwell. We understand that Mr. Rockwell had a clipping service, and the articles went back to him. Because it was his family name, he took them quite seriously.

We would from time to time see top executives come in and have meetings with the press. They would tell them how their presses are operated on Rockwell printing presses, and they're here to stay. This was back in 1976 that they are here to stay, that they're making a commitment to the town. And they closed the doors 2 years later.

Mrs. **Snowe**. On the merger point, are you familiar with the agreement the Draper family made with Rockwell? Was it tax-free stocks or what?

Mr. **Stock**. It was not really the Draper family. That was the problem. If the Draper family had been there, it may have been a little different. Even the Draper management did not control the majority of the stock.

From what I understand what happened, as Draper purchased some of its own subsidiaries, companies that it dealt with almost exclusively for parts for its looms, it made those acquisitions with stock. When the tender was made by Rockwell Standard, there simply was not enough control in one central location to have enough domineering force to stop it. That is why the Draper management knew that shortly after the tender that they either had to negotiate or they were going to be bought out outright.

Mrs. **Snowe**. Thank you, Mr. Chairman.

Mr. **Bedell**. Mr. Tauke?

Mr. **Tauke**. Thank you, Mr. Chairman. I apologize for missing the early part of your testimony. Perhaps you have already covered this ground.

Mr. Stock, could you tell me what your position is in the community?

Mr. **Stock**. My position is the administrative coordinator to the board of selectmen—because of town government, at least the form that we are in Hopedale. In another town, I would probably be the town manager. I am a full-time administrator.

Mr. **Tauke**. Could you tell us how large Hopedale is?

Mr. **Stock**. I think the census figures are going to show that we have just dropped below 4,000 people. In land area, we are about 5.2 square miles.

Mr. **Tauke**. From your observations—and I would be talking to anyone on the panel—do you think that Rockwell made a good investment when they bought the Draper Looms? Was this a good investment for them?

Mr. **Stock**. They certainly bought a going business.

Mr. **Tauke**. Did they make money off of it?

Mr. **Stock**. I don't know that they really turned too many profits.

Mr. **Prouty**. It depends upon what you mean by a good deal. My business for the last 4 years has been involved in liquidation of real estate and personal property for firms that were going out of business, liquidations for banks, rehabing buildings so they could be marketed and taken off the books of the bank.

If they took control of the company in 1967 for $31.5 million and liquidated it 12 years later, the type of machinery that has been liquidated out of that plant is probably worth close to $100 million, maybe more. The plant is 1.5 million square feet, actually almost 1.6 million square feet. In one room there was 45,000 square feet and $16 million worth of tape machines. Another thing being——

Mr. **Tauke**. Excuse me. Were they able to sell that kind of equipment for its value?

Mr. **Prouty**. The Rockwell companies from all over the world came in, tagged the different machines, and they were shipped out to other companies.

The other thing being, whatever was on the books as the depreciated value of this machinery, if a Bridgeport lathe was bought in 1972 for $150,000 and depreciated in 1980 to $50,000, the actual value of that machine today is probably $200,000. A new one cost $350,000.

These are things on paper in black and white you do not see when it comes to the bottom line.

Another thing is there were reports that we have discussed that in 1967 there was probably $43 million worth of cash in the company. Now, where did that go to or how was that written off?

Another thing is, when the company existed as the Draper Loom Works, it had its peaks and valleys but it always survived. When a big corporation buys out a smaller company, the corporate allocation comes off the top. So, when there are peaks, they take the peak; when there is a valley, the valley becomes a little deeper because of corporate allocation. In this case, the corporate allocation probably went to Pittsburgh, and the Hopedale technology, everything that made Draper what it was, that did not come back to maintain that image in the industry or to maintain that technology in the loom works.

Mr. **Tauke**. In layman's terms then, you think Rockwell did OK?

Mr. **Prouty**. From my judgment of what I have seen for machinery, I think they got a good buy.

Mr. **Tauke**. What does Rockwell own now in the community?

Mr. **Prouty**. Raw land.

Mr. **Stock**. About 800 acres of land, which is on the market.

Mr. **Tauke**. Who owns the building, the factory?

Mr. **Stock**. Mr. Prouty is the manager of a group of about six trustees that have recently purchased the building. They bought it for 75 cents a square foot.

Mr. **Tauke**. Mr. Chairman, have we asked Rockwell to testify at these hearings?

Mr. **Bedell**. Have we asked Rockwell?

Mr. **Rosenberg**. Mr. Chairman, the witnesses were selected for their ability to talk about the impact in the local community rather than the details of the merger itself.

Mr. **Tauke**. Mr. Chairman, if I could offer an obsevation. It occurs to me that it would be interesting to ask Rockwell about some of these questions and to ask them why they pursued the policies that they did.

The largest community in my district is Cedar Rapids. Rockwell International, as you probably know, Mr. Chairman, purchased in Cedar Rapids the Collins Radio Co., which is the largest industry in my district. It was a very profitable and going industry at the time. Rockwell, at least by all observations, has brought new stability and new technology and so on to that industry and that business, and it has gone quite well. It seems to me, however, that your community has just suffered terribly because of the policies of the company. It would be interesting to see why they pursue different policies in different cases.

Mr. **Bedell**. We do have additional hearings. I think it would be perfectly proper to ask staff, if that is the wish of the members. We would ask to see if we can work Rockwell in at one of the future hearings and request that they appear before us.

I think they should be told that one of the things we would like to discuss is the Draper Looms acquisition.

Mr. **Tauke**. It is my understanding that Rockwell has said to you people or to people in the community that foreign competition is what drove them out of business in your area. I understand now that they are even receiving some kind of Federal trade assistance because of supposedly the unfair foreign competition.

However, it has also come to our attention that, at the same time that Draper Looms was being allowed to run down, that Rockwell was selling the license rights to its foreign competitors for added income.

Do you have any observations or comments about that?

Mr. **Robert Phillips**. The only information that I have on that is, again, what might be classified as hearsay from people who work in the corporation who were connected with that and who did say that they were engaged in selling license rights to foreign manufacturers for the Draper Looms. We were not intimately connected with the operations of the corporation. But this is what people who worked there told us.

Mr. **Tauke**. Mr. Phillips, you, as I understand it, worked for the company for 45 years?

Mr. **Ben Phillips**. That's right.

Mr. **Tauke**. When the Rockwell people took over and as you observed the management from bottom up so, to speak, did you get any feeling that they took over the plant with the intention of keeping it going? Or perhaps did they take over this operation simply to make whatever money they could off of the assets?

Mr. **Ben Phillips**. I got the feeling they took it over to give a job to the people at Aerospace that went out of business in California.

I also was a plant operator and I chauffeured for a year and a half. They don't have a glass in the chauffeur's door in the car to separate us. I learned a lot. Everybody who came here didn't expect to stay over a year. These were supposed to be high-technology people to replace the ones that built the loom. These people came up here from Aerospace. They didn't know a bat from a ball, but they had a job for a year until they were eliminated.

Mr. **Tauke**. What did they do, anything that related to their expertise in the aerospace field?

Mr. **Ben Phillips**. Filling office space. In reality, they didn't know anything. Yet, this job was supposed to be for engineers.

Mr. **Tauke**. Earlier we received testimony—I think from Mr. Stock—that the research and development was cut back very greatly. It would seem with all these technological geniuses on hand that they would have had lots of research.

Mr. **Ben Phillips**. They cut back Draper's engineers and brought these aerospace people in.

Mr. **Stock**. It was the Draper technology that was responsible for the Draper loom. It was not the Rockwell technology that was responsible for the continuation of the Draper loom.

Mr. **Tauke**. Were all these technology experts that were brought into Hopedale working on looms, or were they working on aerospace matters while they were there?

Mr. **Stock**. Well, there were no aerospace matters. Probably, if we had been able to convince them to put some aerospace into the building, we might still have them there.

Mr. **Tauke**. What did they do?

Mr. **Stock**. They made a valiant attempt to run a business they knew nothing about and took the business down and us with them.

Mr. **Tauke**. Then it would be your observation that maybe they tried but they just did not have the background or the expertise to know what they were doing?

Mr. **Stock**. Well, you certainly have to question their effort. With no continuity in management, with very little acceptance of advice from Draper people who had come up through the system, with the reduction in the engineering and design staff, with very little capital input back into the company, with a community involvement of almost nothing, they simply just did not project the feeling that they really wanted to stay and make the thing work.

On the surface, they could put on a terrific show when the press was there. To give you an example, I think it was in 1977, they came down one evening to announce that the main office was closing. The main office is across the street. It is about 52,000 square feet. It is a fantastic looking building with huge executive offices with 18-foot ceilings with big huge windows and oak-stained staircases and the works. They came down that night to inform us that the building was closing. They wanted to answer questions about the business with the general public as well as show a movie that they had made about the company and the Draper division.

They came into the townhall. Many of the workers who were there who were thinking about their job and their family showed up that evening. The auditorium was filled. The vice president got up and made some opening remarks and said, we want you to see this film. The lights went off; the film went on. When the film was over and the lights went on, they were gone. They left two real estate people from Pittsburgh who were here to start beginning to dispose of the land to answer our questions.

Mr. **Tauke**. Mr. Phillips, do you agree with his assessment that they did not try too hard? Or is it that they tried and were incompetent? Or is it that they did not try to make the company go?

Mr. **Ben Phillips**. They probably tried and were not competent. Besides that, they didn't want to spend a nickel. As soon as they were told by the environmental people that it would cost $400,000 to upgrade the north foundry, they didn't want to spend a nickel. Closed it down.

They had a problem with air pollution in the west foundry, even though electric rates went up and fuel charges went on it. They didn't have the technology to run the thing. I think that they thought they bought a shop, but they didn't know they bought a whole town.

Mr. **Tauke**. Thank you very much. I must say that you are very articulate spokesmen for your community.

Mr. **Bedell**. Yes, sir?

Mr. **Prouty**. In our discussions yesterday with Mark and some others, another point we brought out was that we have seen it happen in Hopedale, we've seen it happen in other towns in Massachusetts where a town has existed with a company for 100 or 150 years. In some cases like the town of Webster, Mass., where Samuel Slater had his mills, years ago the American Woolen Co. bought him out and then Textron bought out the American Woolen Co. and liquidated everything.

Somehow the mills come back. Sometimes it's 5 years. Sometimes it's 20 years. In the case of Ware, Mass., they've never come back.

We see this happening again. What we do is look at the Worcester papers and see articles about the American Optical Co. in Southbridge, another Draper-type community. It is probably 18,000 to 20,000 population. They had a work force at one time of 5,000 to 6,000. The work force is down to 2,200 now. You read the newspapers. What Rockwell International was saying 4 or 5 years ago, the American Optical Co. or Warner Lambert officials are saying the same thing now. They laid off people 2 years ago that had worked there for 20 and 30 years executive positions, saying that they were going to try to make the American Optical Co. more competitive, they were going to consolidate things. They were going to try to bring the company back.

Instead, we have seen the company go from 6,000 to 5,000 to 3,200. Now there are approximately 2,200 employees. They are closing down branches of the factory and saying that they phased this out or that out for the sake of competition. What people in our position see, we see corporate allocations again. The company will soon be liquidated. Then we have another abyss of 2 million square feet and 5,000 or 6,000 jobs gone.

Mr. **Bedell**. Apparently you are involved in the sale of assets of this type. Do you see our tax laws as part of the problem? Does it appear to you that the tax laws make it advantageous for a company to close out and divest themselves of assets in these cases where, rather than encouraging these businesses to continue to operate, we give them financial encouragement to close out? Or does that not appear to be a problem?

Mr. **Prouty**. One of the problems I see, for example, is the depreciation of machinery. When you get into high technical machinery like machine tools, on the books it is depreciated and it can be transferred. For example, a lot of the tools that I saw in the Rockwell International plant went to Cedar Rapids. Those were the tags on it. So, they go to another division. But what happens is, on the books, if a machine is depreciated to $50,000, like I mentioned before, because of inflation and the high cost of new machinery, it is actually worth three or four times that.

My feeling and the feeling of the other people with me is, when Rockwell was bought for—I still feel for $31.5 million, even though it was 1967 dollars, quite a bit came with it. It was the town. It was a lot of real estate, a lot of machinery, and a lot of cash.

The thing that hurts me and we have all discussed is, are we going to be a country that is going to give up our American Optical Companies, and our Draper Looms and high-technology items that have serviced the world over; and are we going to become insurance salesmen and hamburger people? You know, we are getting down to the nuts and bolts. We see a lot of good, strong companies where what was good for the town was good for the company and was good for the country and actually good for the world. We see a lot of these things being phased out because maybe they made 5 percent profit and not 18, 20, or 25 percent profit.

Mr. **Tauke**. Did you say that they paid $31.5 million for this company?

Mr. **Prouty**. Just from what I see in newspaper clippings. It said control of Draper would cost $31.5 million.

Mr. **Tauke**. The company had $30 million in cash on hand?

Mr. **Prouty**. We saw in one report it was $43 million.

Mr. **Robert Phillips**. We have just seen that in various reports.

Mr. **Stock**. We can go to the secretary of state's office in the Commonwealth and see what assets and liabilities were filed. They were filed under the State of Maine?

Mr. **Robert Phillips**. No. They filed with the Commonwealth of Massachusetts on their certificate of condition that they are required to file. They merely filed all of the assets of the whole Rockwell company. So, it's billions of dollars. So, it is impossible to separate what they attribute to Hopedale.

Mr. **Tauke**. How much was Draper worth at the time it was purchased, and how much did they pay in order to go through with this stock swap?

Mr. **Robert Phillips**. They exchanged shares. No money passed.

Mr. TAUKE. But the shareholders apparently felt they got a good deal?

Mr. ROBERT PHILLIPS. I think they did.

Mr. TAUKE. And the shareholders are probably still happy.

Mr. ROBERT PHILLIPS. I think that the shareholders made out all right. Rockwell made out.

Mr. BEDELL. It seems this is a problem we face. If there was a corporation that was short on cash and if it could then acquire a company that had cash by simply giving them some shares of its stock which could then be sold, the company could significantly increase its cash position. Indeed, if they are looking for cash, there is even further incentive for them to do that and then sell off the assets in order to gain cash. That's why I asked the question about our tax laws.

I think we need to try, if we can, to look a little bit at whether or not this is a serious problem in our society.

Mr. TAUKE. We are both at the same point. Apparently what happened here is they had $30 million or $40 million or something like that in cash, which was depleted to $8 million after 1 year with no capital investment in the Draper Looms Co. So, Rockwell picked up a lot of cash probably in order to invest in other aspects of their business. That is what would appear to have taken place, if I am understanding correctly.

Mr. BEDELL. If I understand it, they bought it by giving stock in Rockwell rather than having to pay cash.

Mr. TAUKE. Right. Then they disposed of the assets and picked up more cash.

Mr. ROBERT PHILLIPS. We did hear of one company they bought in Boston. It was called Boston Gear Co., makers of a very good machine product. It went much the same as Hopedale. It went right down to the bottom. But the former owners bought it back again. Now they brought it right back to where it was before.

Mr. BEDELL. It would appear that although the business may be important to a community because of the employment and what it is doing for that area, in a conglomerate, the corporate management could easily overlook these important factors. If there is more profit at Collins Radio than in Draper Looms, they could issue the stock and get more money out of Draper Looms to use to expand Collins Radio to make the company more profitable. And tough luck for the community in which Draper Looms is located.

Mr. TAUKE. They probably financed buildings in Cedar Rapids, Iowa, with the operation in Hopedale.

Mr. BEDELL. Maybe you're fortunate that you are from that area. We appreciate your testimony very much. We appreciate your coming down here to give it. We think you are very articulate in helping us to understand the problems in your community. Thank you very much.

PANEL CONSISTING OF REPRESENTATIVES OF COLONIAL CO-OPERATIVE PRESS, INC., CLINTON, MASS.: JOHN SAULNIER, JOSEPH CASASANTO, AND STEVE DAWSON

Mr. BEDELL. Our next panel is a panel from Clinton, Mass. We have a practice of swearing in our witnesses.

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Mr. SAULNIER. I do.

Mr. DAWSON. I do.

Mr. CASASANTO. I do.

TESTIMONY OF JOHN SAULNIER, COLONIAL COOPERATIVE PRESS, INC., CLINTON, MASS.

Mr. SAULNIER. I am going to make an almost entirely personal statement. I have had the unique privilege of seeing much of what happened. I was familiar with the people that came in from Sheller Globe. I had worked at Colonial for 19 years before S-G arrived. I stayed until the closing of the plant.

I talked to many of the people concerned, both the management at Colonial and the Sheller Globe people. I have chosen to give you a personal narrative of what it was like to be there when it happened and to watch it go down the drain.

I have very mixed emotions about all this. My feeling about people generally is that there are no heroes and there are no villains; there are just people in heroic situations and in villainous situations. I think that the people at Sheller Globe were as much victimized by this association as we were and that they were trapped by circumstances that caused them to behave with the result that they paid more attention to economic forces or rules and regulations within the company that did not allow them to follow the dictates of their conscience or more humane leanings.

I do not want to characterize the people from Sheller Globe as villains and the people at Colonial Press as heroes. I think we were all doing what we seemed to think was the best to do at the time and the circumstances. That is perhaps what we should most concentrate on. If it is profitable for larger corporations to liquidate smaller ones, they will continue to do so. If it is profitable for a corporation to sell another company as a going concern, then I think they would perhaps sell it as a going concern. I think we are talking about broad economic policies and not human frailty or human greed.

The Colonial Press was started in 1931, the year I was born, by Louis Adams. It was run as a family business until 1968, when Mr. Adams sold it to Victoreen, Inc., a New York holding company with a staff of three or four people. It was generally understood that Mr. Adams sold it to protect his family's interests. Mr. Adams was in his eighties and was unable any longer to take an active interest in the business.

Victoreen bought Colonial the year following the best year we ever had. Due to short-term economic circumstances, the book business boomed in 1967. Colonial shared in that boom and brought in about $1 million in profit. The years immediately before 1967 had seen a fairly regular profit of about $200,000 a year. We never generated that high a profit again and, in effect, returned to the $200,000 level.

Victoreen merged with the Leece-Neville Corp., which brought the new company, VLN, Inc., into the automotive field by way of fractional horsepower motors for top of the line automobiles, the type of motors that move seats back and forth and windows up and down in Cadillacs and other large cars. Victoreen spent money in cathode ray tube composition and in the pressroom but not in the bindery. They put pressure for higher profits on our management, and we lost our president, a man who subsequently proved his ability with one of our competitors. He was replaced by an accountant with no book manufacturing experience and little aptitude for it.

Sheller Globe merged with VLN in 1975 with Sheller Globe as the surviving corporation. Their expressed purpose in the merger was to acquire those companies in automotives. I was told that Sheller Globe was a large Ohio-based company with sales close to the one-half billion dollar mark which had grown chiefly by means of acquisition. Colonial at this time was close to the $30 million sales level, making it a major force in book manufacturing, if not one of the very largest.

Sheller Globe sent a task force—their phrase—to Colonial late in 1975. From their recommendations, we lost our accountant/president, acquired a new general manager by promotion, a new plant manager by promotion, a new treasurer by promotion, and from Sheller Globe a vice president of operations and a new materials manager. A little later we acquired a new president whose strength was in school textbooks and magazines, in neither of which fields we had any experience. He hired a new sales manager whose experience had been in Bible sales. We had no experience manufacturing Bibles either. Then began a series of changes, rapidly, so described by Sheller Globe as necessary to make us leaders in book manufacturing.

In contrast to the testimony you just heard concerning the Draper Corp., what happened at Colonial Press with Sheller Globe happened very quickly.

The chairman of the board at Sheller Globe told our assembled customers in a function room at the top of the Pan-Am Building in New York at a cocktail party that Sheller Globe was in the book business to stay. He also said that making steering wheels was not different from making books: a statement that amused some of our customers but not those of us from Colonial. I do not know if he was really committed to the first statement, but I know he really believed the second.

Sheller Globe was accomplished in operations management, demonstrating good skills in accounting, control of indirect labor, and tight purchasing procedures. Had they confined themselves to the improvement of plant operations, we, Colonial, would have prospered. However, Sheller Globe management showed a high degree of arrogance toward the Colonial managers, our methods and systems. Our sales effort, our customer service—a vital part of book manufacturing, rather than a window dressing, as it proved to be in automotive manufacturing—our order writing, our estimating, and our billing were all criticized, attacked, and crippled. Within 6 months we were in a shambles.

Our customers became upset and angry; our ability to write orders, to schedule work through the plant, and to report that progression to our customers by means of status reports, our pricing, and our self-confidence were systematically destroyed. Rival factions developed, infighting for positions close to Sheller Globe power became common, and too little productive work was performed by middle-level management.

When Sheller Globe took over, I was composition coordinator, a fancy phrase for a composition expert whose duties were to explain the intricacies of cathode ray tube composition to our sales force and customers when needed. I then became assistant sales manager, then scheduling manager to which was added responsibility for the planning department with some discussion of my also getting customer service and order writing. From this latter position, I met all the visiting Sheller Globe group vice presidents and Sheller Globe corporate staff vice presidents who descended upon us all asking the same basic questions, getting the same answers, and ignoring the same with varying degrees of politeness but equal obstinance.

Hot metal composition was closed. CRT composition was closed. Letterpress printing was closed.

Our customers were being driven away before and faster than new ones were acquired. Work was secured, the like of which we had never seen before with the result that our performance was appalling. Books were ruined to be done over or done at great, unrecoverable cost. At one point it took us 3 weeks to get a new order from a salesman's hands through estimating for a price check against our original quote, through order writing and scheduling to the plant, when we were giving 4-week delivery dates. Some of our competitors were giving at that time 3-week dates and meeting them.

I subsequently worked for a company that printed and bound books regularly in 1 and 2 weeks, but then that was without Sheller Globe's help.

We changed out text sheet, the paper you print on, which we sold to our customers as a convenience to them and a profit item to us, to one which was of inferior grade and unacceptable to most customers. We did it without consulting any customer. There were rumors, perhaps unjust, that said that there was profit to be made to individuals by this move to a new paper supplier.

We combined our customer service function with our order writing function and reduced by at least one-third the total number of workers. Utter confusion resulted. At least one-half the time, people were doing work for which they were untrained and perhaps unfit, the two operations requiring totally different skills. The room in which they were moved was a poorly heated converted loading dock which was too small and too noisy.

Our first-line contact with our customers, the most frequent contact between any Colonial person and the publisher, was ruined. Some of the people in their confusion and frustration exposed our problems directly to the customers, theirs being now the only friendly ear. It was pitiful and painful to even enter their room. But, to their credit, no one quit; they continued to try to function.

Customers were used to the practice of laundry list quotations, wherein each item of manufacture was listed separately with its price. Sheller Globe unilaterally decided to drop that practice and went to a unit price, that is, price per book 65 cents. It is a practice common, I believe, in their business, not ours. When customers complained, they were told they had no choice in the matter. Some of our sales people actually made out dummy quotes that they sent to our offices for filing while they made out quotes more suitable to the customers' requirements.

When I or anyone else close enough to speak with the vice president of operations complained or criticized any directive, no matter how trivial, we were answered by a gesture toward the invisible insignia of rank that that person wore on his shoulder, much as a young lieutenant might point to his bar as a proof of his position, your lower position, and his power over you. It was humorous until you thought about it. Rank, not reason, ruled.

It sounds difficult to believe, but Sheller Globe built a high chain-link fence around three sides of the property and put about 12 guards on the gates around the clock. We were given photo name badges to wear at all times and were subject to search when leaving the premises. I had the trunk of my car searched while a customer was with me. The customer asked me if we did much Government work.

I believe that there were probably two factions at Sheller Globe corporate headquarters, one wanting to keep us and make us work, one wanting to dump us. One Sheller Globe man said to me: "If we can't make this place work, no one can." That statement is liable to two interpretations. Given subsequent events, however, I think it is easy to see which faction won. As long as it is more profitable to liquidate than to sell, companies will be liquidated.

I am sorry I did not keep a diary of those months, but I did not; and much that I cannot recall would be of interest to you. It was painful to dwell too long on past problems; there were always new ones. I wish I could properly relate our frustration and anger, but I can only say that it was so. When I was terminated in the spring of 1977, it came with a sense of relief. Being without a job after 19 years at the same company, I saw the uncertain future as pleasant. I took a job in New Jersey and left Massachusetts.

I returned when it became apparent that the new cooperative would die before birth if I did not take the job as president. We currently employ around 20 people and struggled to prosper, taking comfort from knowing that, should we fail, it will be from our own inability to make it go and not as the result of an impersonal accounting decision.

I invite your questions. Perhaps you would like to let Joe give his testimony.

Mr. Bedell. Thank you.

Mr. Casasanto?

TESTIMONY OF JOSEPH CASASANTO, COLONIAL COOPERATIVE PRESS, CLINTON, MASS.

Mr. Casasanto. Shortly after Sheller Globe took control of the Colonial Press, they sent a task force from Toledo, Ohio. When they arrived in either September or October 1975 a meeting was held with union officials to announce a change in management and what they intended to do about upgrading Colonial. A local employee was designated as general manager, but they inserted their own personnel in key positions. They in reality controlled the operation using the local general manager as a figure head.

I have always felt—and this feeling started about halfway through our meeting with the task force—that they would be running Colonial; and the local manager was put in to help the employees feel secure and at ease that a local man was in charge. Later events proved this assumption to be correct.

The task force from Sheller Globe made many changes, some good and some bad. On the good side, we moved everyone into one building and reduced the nonproductive labor force needed previously in producing books in two buildings. These moves resulted in our producing more books with around half the labor force. The poor side was that our labor relations went downhill.

In August 1976, a new president was hired to run Colonial. He was an admitted antiunion man and worsened the labor problems; and, instead of going forward, we went backward.

Around December 1976 a letter was sent out to customers stating that Colonial expected to have labor problems and could not guarantee delivery. This seemed strange, as the only labor problems we had were instigated by management. Our contracts were up April 1, 1977, and negotiations were begun in late January. Then a strange thing happened when we presented our proposals, about 20 changes or so. The chief negotiator for Sheller Globe said they did not have any. Not only that but the Sheller Globe negotiator thought some of ours were so humorous they openly laughed about them.

We were scheduled for a meeting in February, but it was postponed until March 17 at 9 a.m. This meeting, not coincidentally, coincided with the departure of President Carter from Clinton at exactly the same time of day after his historic visit to Clinton.

At this meeting we were informed that Colonial would be sold or liquidated, the decision to be made by April 1. We were asked to discontinue our negotiations but that Sheller Globe would be willing to continue if we so desired. During this period, Von Hoffman and Banta showed interest in purchasing the company. We even spent about 26 hours negotiating a contract with Banta, only to see it all go down the tube because for some reason an agreement to sell could not be reached.

In the meantime, myself and a few others decided to check into a plan I had for employees to purchase Colonial. We contacted the Industrial Cooperative Association, an organization interested in employee-owned companies.

After meeting with ICA, we had a meeting with the employees at the Clinton townhall, and 600 employees voted unanimously to attempt to form our own company to be named the Colonial Cooperative Press, Inc. In 7 days we collected around $400,000 in cash and pledges. This amount is what Sheller Globe said we would need as a start toward purchasing Colonial. We then made an offer which was $10,000 more than the other bidder. I personally called Sheller Globe and was told that we were not in a bidding war and that they felt we would probably lose our life savings and that the backers of the other bidder had a line of credit of $20 million.

As for losing our life savings, most of us were losing them anyway because we were unable to get jobs. The day that the deal with the other bidder was to be closed, they backed out of it and Sheller Globe proceeded with their liquidation plans.

I firmly believe this was nothing but a bag job and they intended to liquidate all along no matter what happened to the employees or the community.

The closing of Colonial had a disastrous effect on the employees and the community as a whole. Unemployment rose from 5 percent to about 12 or 13 percent. People got behind in their bills. Marriages were going on the rocks. Some turned to drinking heavily. I personally collected unemployment for the first time in my life, and it was very embarrassing. Also, being over 50 years old, it was very difficult to find employment at the same pay level. As the father of nine children, I can tell you I spent many a sleepless night and some very long days.

Because of this and the fact that I prefer to make or lose money on my own capabilities, we continued with the plan to form our own company.

We were incorporated in May 1978 and started operating in November 1978. We are operating now in composition and doing some hand bindery work, working toward the day we will do a complete book from composition through printing and binding.

I certainly hope and pray that my testimony will in some small way help to stop the unnecessary closing of plants by out-of-State conglomerates who treat people as numbers and not as human beings. Thank you.

Mr. **Bedell.** Thank you.

Mrs. Snowe?

Mrs. **Snowe.** Thank you, Mr. Chairman.

I could not gather from your testimonies whether or not the company was unionized. Were they?

Mr. **Casasanto.** Yes.

Mr. **Saulnier.** It was not an international union. It was a plant union.

Mrs. **Snowe.** It was a local plant union. So, you were not able to improve labor relations at all through the labor union? It sounds to me from the testimonies that the labor problems became progressively worse as time wore on.

Mr. **Saulnier.** It was almost more than that. I think perhaps it was personal problems. Management behaved—when I say "management," I mean Sheller Globe management—in many ways, as if there was no union. They antagonized workers. The new president we hired had a practice of walking to the floor and speaking improperly and out of turn to workers.

As Joe said, I think it was clear that they had no intention of really dealing with the union.

Mrs. **Snowe.** Why was Sheller Globe so adamantly opposed to employee purchase of the company? As we will hear later on, Bates Manufacturing in my hometown was very successful in enabling the employees to obtain Bates Manufacturing. Why was Sheller Globe so opposed to it?

Mr. **Saulnier.** I think perhaps it was dollars and cents. The last price I heard quoted on Colonial was about $3.4 million, and my understanding is that they totaled $7 million on liquidation. I think it——

Mrs. **Snowe.** So, they were able to liquidate at a higher price than they were to receive a lump sum.

Mr. SAULNIER. I think there was something else, too. The Sheller Globe people had a great deal of pride in their ability and what they considered the Sheller Globe way. I think one of the things that went wrong is they were trying to make a Sheller Globe out of Colonial Press. If it meant cramming a round peg in a square hole, by God, they were going to do it. And they couldn't do it.

The man who said, "If we can't run it, no one will," I think he meant it quite deliberately as a personal thing, too.

Mrs. SNOWE. Would you say that there were a number of problems involved in contributing to the demise of the company——

Mr. SAULNIER. I think that there——

Mrs. SNOWE. Mismanagement? Labor problems? What would you say?

Mr. SAULNIER. There were so many. I think that we cannot properly identify all of them. I think, if you are going to have a common problem with all of the testimony, I think it will be just that. You cannot pin down all of these things.

Colonial Press was not the best run company in the world before Victoreen bought it and indeed when Sheller Globe bought it, and there were indeed problems at that time. But they became exacerbated. They did not help them; they made them worse.

As to why they did it—I watched the chairman of the board of Sheller Globe talk at the Pan-Am Building in a room that was 75 or 80 feet long. You could look out across the river and see the sun setting in the west. He stood there and I think he became enamored of book manufacturing and publishing. He said: "I think there's a little something better to that than making bumpers and rubber steering wheels and bathtubs." So, I think he meant it when he said that they were in for good. But the chairman of the board of Sheller Globe does not make the operating decisions in a plant in Clinton, Mass.

The particular personalities of the individuals that were sent by Sheller Globe had a great deal to do with what happened to Colonial Press. Whether they were accidents of personality or deliberate policies, you will have to talk to Sheller Globe to find that out.

Mrs. SNOWE. Did Sheller Globe bring in their own employees from other industries?

Mr. SAULNIER. No. God help us, we were spared that. They brought in management but no workers.

Mrs. SNOWE. I guess what I am trying to understand here is this. Did the company disintegrate because of Sheller Globe or because the demand was not as great, or they were not operating the company profitably, or what?

Mr. SAULNIER. The company was being operated profitably before Victoreen purchased us and as we were being operated by Victoreen and Sheller Globe purchased.

Mrs. SNOWE. So, it was a profitable operation when Victoreen——

Mr. SAULNIER. Yes. It wasn't a great deal of profit, and it certainly wasn't the kind of profits that Sheller Globe liked to see from their—we had a corporate allocation, some $40,000 a month off the top. Times 12, that's a big chunk of money for a company that was probably trying to make a profit of $200,000.

I mentioned the fence. That bloody fence was around three—you know, there are four sides to a square. They put a fence around three of them. That was an enormous expenditure of money. If it was to stop us from stealing books, the fourth one was the way they would have gone out the door. It was on a railroad track, and you could have dumped out thousands of books an hour if we really wanted to steal them.

I understand there was a childhood friend of the chairman of the board whose job was to oversee plant security for all Sheller Globe plants. His job was to put fences around property. That is what they did when they bought companies. They put a fence around them. They gave you badges, and they frisked your cars. That was the philosophy.

Don't get me wrong. As I said, operationally they were very good. I learned a lot. I watched these people very closely. They ran a good production. They controlled labor very well. They knew how to handle numbers very well. They proved it.

They did not know how to handle people very well.

Mrs. **Snowe.** It was more of a personnel problem?

Mr. **Saulnier.** I think you could say that; yes. I had a personnel problem.

Mr. **Casasanto.** Don't you think they never wanted to run Colonial Press at all?

Mr. **Saulnier.** I think some people did and I think some people didn't.

Mr. **Casasanto.** I don't feel that way.

Mrs. **Snowe.** Did Sheller Globe say exactly why they rejected the employees' proposal: because it was not enough money? They considered they could do better?

Mr. **Saulnier.** As Joe pointed out, they said that they did not want the employees to lose their life savings.

Mr. **Casasanto.** I was told that.

Mrs. **Snowe.** They felt the employees could not run the company profitably?

Mr. **Casasanto.** I think maybe they thought we could run it, and we might show them up a little bit.

Mr. **Dawson.** Congresswoman, it was also that they were at least attempting to negotiate other buyouts with one of the managers with other outside owners. The employees' offer was always put last on the burner. But the time all the other deals finally fell through, they had probably realized that the quickest and easiest thing to do would be to liquidate.

Mrs. **Snowe.** Thank you.

Mr. **Bedell.** Mr. Tauke?

Mr. **Tauke.** It sounds like there are some parallels between this experience and the one we heard earlier. It seemed as though in the last panel there was some difference of viewpoint as to whether or not the company really wanted—in this case, Sheller Globe—really wanted to make a profit and wanted to run this company an efficient way.

As I understand it, you believe that there was an intention on the part of Sheller Globe really to make it a going business, but they just did not know how to do it.

Mr. Saulnier. My feeling is, there were so many people at Sheller Globe in a position to make or influence managerial decisions—when I say vice presidents descended upon us, I mean vice presidents descended upon us. On the way down to the Virgin Islands, they would stop by in Boston, come in, ask a couple of pertinent questions, and zip out again. They would ask questions until they got an answer they liked and then they would act upon it, ignoring all other previous answers.

But I do not think that Sheller Globe had a cohesive, pertinent policy. I think that decisions were made at the top and then the people that had to implement these decisions probably had differing views themselves. I think there were—Joe argues with me, and he probably will till the day he dies. He thinks it was a unilateral decision on their part. But I don't think that much of Sheller Globe's operation. I don't think they really knew what they wanted to do, and they were fiddling around for an answer.

Economics provided that answer. But I think, had they been able to make a good profit, they would have kept it.

Mr. Tauke. But they just did not have any understanding of the business or how it operated, so they blew it?

Mr. Saulnier. I think that they very quickly formed the opinion that our opinion was not worth consulting. They simply acted on their own limited experience and knowledge of what we were doing.

Mr. Tauke. Mr. Casasanto, you have a different viewpoint. You think that, from the beginning, they just really did not intend to keep this company going.

Mr. Casasanto. If they intended to keep the company going, why, when they first came in there, did they take all the time clocks? It aggravated everyone. We had them separated where—you would have to understand what I'm talking about. We work in a long building that is probably a mile and a half long. So, we had timeclocks in the pressroom and receiving area, the perfect bindery, the main bindery, and on the shipping area. They took all of these timeclocks, put them right in the center of the building, and made everybody converge from both ends. We all had to go out one little door so that we could be observed with our badges and our bags, whatever.

Mr. Tauke. Was there a problem with stealing?

Mr. Casasanto. There is always a problem with stealing in most every company, but it was not a big problem. Someone always takes books. If you are making books, there is always someone taking a book. But they always made their production that had to go out of the shop; so, evidently, we did not have that big of a problem.

The fence was a big thing. They kept you locked in there.

It was very aggravating. It started out that way. They unilaterally decided that, whatever was said in our contract, they could change it anytime that they wanted.

We had at least 20 unfair labor practices filed against them. We had grievances go all the way to arbitration. We won every one of them, which only goes to prove—they did these things just to aggravate everyone and keep you going all the time.

They knew absolutely nothing about making a book. In fact, we were making a cover. After making about 10 or 20 covers, I noticed that the top of the cover was bubbling after the glue was put on. I notified the supervisor, who got ahold of the man who came—I don't know if I should use names or not. We got ahold of the man from Toledo. He came down. He said: "Well, I'll call Toledo, and I'll see if we should send these out." So, they came back about 20 minutes later. They said: "Go ahead and make them, and we'll make the books."

We made 60,000 books with bad covers on them. They came back 2 weeks later. So, those had to be made all over again.

Now, if they were trying to run a company profitably, why in heaven's name would they do a thing like that? Why would they have to call Toledo, Ohio, to ask someone how good a cover was when they don't even know how you make them? I don't understand.

Mr. **TAUKE**. As you look back at the investment by Sheller Globe, did they make—was it a good deal for them to purchase the Colonial Press?

Mr. **SAULNIER**. You have to remember that they did not buy Colonial Press; they bought Victoreen.

If you are only talking about dollars, I think they didn't do too badly. In the year and a half or so that they owned us, they took out as much as they could. I think it paid for the fence and other things, too.

Mr. **TAUKE**. Did they dispose of the assets of the company?

Mr. **SAULNIER**. Yes; the land, the buildings, the equipment.

Mr. **TAUKE**. What kind of price did they get for that?

Mr. **SAULNIER**. A total of about $7 million, including tax writeoffs.

Mr. **TAUKE**. Including what?

Mr. **SAULNIER**. Including tax writeoffs for liquidation. They go about $7 million.

Mr. **TAUKE**. Apparently they paid—someone estimated; I am not sure which of you—about $3.5 million——

Mr. **SAULNIER**. They would have sold it for $3 million——

Mr. **CASASANTO**. I think they bought it for $4 million. I am not sure.

Mr. **SAULNIER**. The price that Victoreen put on us when it was sold, I think is so complicated and shrouded in mist that you will never find out the true purchase price.

Mr. **TAUKE**. If it was somewhere between $3 and $4 million, as you have estimated, and they were able to pick up $7.3 or $7.4 million by selling it or liquidating it at the end of the year and a half, they did not do too badly in their investment.

Mr. **SAULNIER**. No.

Mr. **TAUKE**. Thank you very much.

Mr. **BEDELL**. I think the last line of questioning points out a problem. Apparently this was a family business whose profits after tax would normally be about $200,000. You could hardly expect anybody to spend more than $3 or $4 million for a business that makes a profit of $200,000, which would be 5-percent return on the investment, when interest rates are high.

Then, if I understand things correctly, regardless of whether they ran it properly or improperly, they come to the point where they have the choice of selling it to the employees for $3 million or liquidating it for $7 million. I do not believe there are many corporate managers that would sell it to the employees for $3 million rather than liquidate it for $7 million.

All of this completely ignores the local situation and the employees that work there and the impact therein.

I have to assume that, if it had remained a family business and the family continued to operate it, even in spite of the poor return, you probably could have expected this business to continue to go on with management that could at least keep the profit at the $200,000 level. It probably would have continued even though that is not a very good return for the investment that they had in it. Is that accurate?

Mr. **Saulnier**. I think that may be a fair assessment of the facts. The problem is, however, that in the book manufacturing business, old, family owned, almost marginal book companies have been disappearing for years. There has been a dialog going on over the remaining small book manufacturers that, if you do not support us now, you are going to deal with the conglomerates later. Our customers paid no attention to that kind of discussion. They are beginning to, I think.

Mr. **Bedell**. Do you know whether other book manufacturers with whom your business competed had profits significantly higher as a percentage of their investment, as compared to what you had at Colonial?

Mr. **Saulnier**. Yes; I believe some were. The truth is that many of them are owned by large conglomerates. There are many very fast-rising young companies in book manufacturing, printing, or binding that are buying companies that are marginal and fixing them up and running them at a profit. It can be done; it is being done.

Mr. **Bedell**. And you believed Sheller Globe tried it and failed?

Mr. **Saulnier**. I believe that, in part, yes; I think there was always an operation facility that wanted to make it run. I think there was probably a financial faction that thought it was wise not to do it.

Mr. **Bedell**. You mentioned the tax writeoffs for liquidation as part of the $7 million. Are you knowledgeable about what those are?

Mr. **Saulnier**. No.

Mr. **Dawson**. In one of their annual reports they state specifically the amount of tax that they received for the sale. It did not go into the description of how, what different parts of the tax law they took——

Mr. **Bedell**. It seems there is great concern if we have Government tax laws which reward people for liquidating firms in communities and cause great disruption within the community.

Mr. **Tauke**. As you pointed out, Mr. Chairman, it is tough to blame a major company for making what seems to be the prudent business decision if their objective is to make money, which is the objective of most businesses that I am familiar with.

What we can look at is the tax incentives that maybe are encouraging this kind of problem.

Mr. **Bedell.** I think we should direct our staff to try to take a look at this to find out whether this is a significant factor contributing to this particular problem.[1]

Are there any further questions?

Mr. Dawson?

TESTIMONY OF STEVEN DAWSON, INDUSTRIAL COOPERATIVE ASSOCIATION, CAMBRIDGE, MASS.

Mr. **Dawson.** Mr. Chairman, I have just one or two short points to help the subcommittee in its investigation. Looking at the case studies that you will be hearing from today and tomorrow, it seems that you are looking at only a part of the problem. With the possible exception of American Safety Razor, which I am not familiar with, the four other cases are liquidation situations. There are a number of what are commonly called runaways, companies that are moved from the Northeast down to either the South or out of the country. They experience different tax laws, different tax advantages.

I think the subcommittee might want to investigate those differences and perhaps try to hear from instances in which a company was not liquidated but simply picked up and moved to where a cheaper work force was available or environmental regulations or the enormously increasing competition between States, in which States are providing on State level advantages to try and attract companies from where they are.

The other area that is not covered by these are large retail operations. Most of these are company-town situations. For instance, large foodstore chains are closing down in the inner cities all over the Northeast. It has a great deal of effect on the small businesses: Shoe repair, small grocery stores, whatever, which are dependent upon the foot traffic which a large supermarket attracts.

As an example, in Massachusetts the First National Food Stores have closed down; I think, in the last year it was six stores right in the Boston urban area. They were recently acquired within the year by a major conglomerate out of Cleveland, called, I believe, Pick-'n-Pay.

The effects of those closing on inner-city, low-income merchant areas are enormous.

Mr. **Bedell.** They were acquired and then closed, you are saying?

Mr. **Dawson.** Yes; a large conglomerate recently bought the entire First National food chainstore.

Mr. **Bedell.** And closed some of those stores. Is that——

Mr. **Dawson.** Are going around and cutting out a number of the stores——

Mr. **Bedell.** I assume they looked at them, and the ones that they felt did not have the profit potential were closed.

Mr. **Dawson.** Certainly they are making economic decisions on how to raise the profit level of the entire chain, yes. What I am trying to point out is the effects on small businesses of large retail closings. They are also having a great deal of effect on inner-city communities and inner-city businesses.

---

[1] Committee Note: In Appendix C, Senator Metzenbaum discusses the tax considerations of the liquidation of Colonial Press with John R. Eastman, president of Sheller-Globe.

One other point is that one thing that has not been underscored is the effect of these large closings on small businesses and even the big company towns. There has not been any research specifically in Clinton, but I think you may hear from Youngstown. Their estimate was that 5,000 jobs are lost with the closing of Campbell Works, the Sheet and Tube. Their estimate is an additional 6,000 jobs were lost in small businesses that were dependent upon either supplying that company or dependent upon the workers who had brought home paychecks and had their shoes fixed in small stores, et cetera. So, there is evidence, and that should be explored by the staff, I think.

Mr. **Bedell.** He brings up a point that there are States that have tax laws which encourage a conglomerate that buys a plant to pick up that plant and move it out of the community and move it to another State. This occurs without regard for what that is going to do to the community from which the plant is moved.

It seems you bring up a concern that is a legitimate concern at the national level. If we have States whose laws ignore the effects of moving plants from one place to another and ignore the impact that that has on the community and the individuals involved, I see that as a legitimate concern.

Mr. **Tauke.** Mr. Chairman, is this the result of simply different corporate tax structures from one State to another? Or is this the result of specific nuances in an individual State's tax laws?

Mr. **Dawson.** It is a number of factors. That is one of them. We are not simply talking about moving companies from one place to another within the United States. We are talking about, also, having companies move outside the country to where they can get $1.25 an hour labor or 43 cents an hour labor.

But, between States, there is the tax advantage differences. There is also what is called State entrepreneurship now. There is a book which I recommend to the staff called "The Last of the Great Entrepreneurs," by Robert Goodman. That book specifies this exact process that is going on, where States are vying with each other to attract different companies.

From Mrs. Snowe's State, there is a very well-known recent example of that in Pratt & Whitney. The Governor went way out of his way publicly to make sure that the company would arrive. And now there are questions in terms of environmental effects, et cetera, of that company.

But there are differences in those tax structures that they try to make.

Mr. **Tauke.** My own State has single-factor corporate tax which most States have three factors. Without getting into any discussion of that, that is designed to encourage industry to come to the State.

Some States will say: well, if you come to our State, you have 10 years' forgiveness on your property tax, and so on. It is fairly difficult, I think, Mr. Chairman, for us to get into that kind of problem.

However, if it is something akin to the farm problem, where foreign owners of farmland do not have to pay capital gains taxes while domestic owners do, then it is something it seems to me we can get into.

Mr. **Dawson**. At least on the national level the tax advantages of moving companies outside the country should be looked at very closely. In the State of Massachusetts we are losing an enormous number of jobs to Taiwan, to Mexico.

Mrs. **Snowe**. Mr. Chairman, if I may follow up on that point. You are correct. I know in Lewiston, Maine, for example, we are losing Arrow-Hart Co. to Mexico simply because they can buy physical facility and labor for much less then their operating or rented facility in Lewiston, Maine. In addition to that, there certainly are much higher labor costs.

I agree with Mr. Tauke saying that we cannot get into regulating, obviously, the variances in State laws. But I know that communities do vie with one another for the attraction of industry as well. They also regulate their property taxes to benefit a corporation if they can entice them to locate in their area. There is no question in the case of Pratt-Whitney the Maine State Legislature gave a tax break to that company in order for them to settle and stay in Maine.

Mr. **Saulnier**. Mr. Chairman, there is a law on the books that is about to disappear, I believe, having to do with copyrights and publishing. In the past, if a publisher wanted to retain the copyright on a book, he had to have it manufactured at least in part in this country. That law at least looks like it is going to lapse. If it does, it means that, if perhaps not in the first printing, then in subsequent printings the publisher could go, for instance, to Taiwan and get a book manufactured, retain his copyright here in the country and internationally at enormous price savings.

Publishers are reluctant to talk about the financial effects of this law. If they chose to take advantage of it, it could mean enormous changes to book manufacturing.

Mr. **Bedell**. Could we ask our staff to check on that law and find out what the situation is. [See Appendix D.]

We thank you very much for appearing here. It has been most helpful to us.

PANEL CONSISTING OF REPRESENTATIVES OF BATES MANUFACTURING CO., LEWISTON, MAINE: RAYMOND ST. PIERRE AND JOHN C. TURNER

Mr. **Bedell**. Our final panel comes from Lewiston, Maine.

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Turner**. I do.

Mr. **St. Pierre**. I do.

Mr. **Bedell**. Mrs. Snowe, would you like to introduce our panel?

Mrs. **Snowe**. I certainly would. Thank you, Mr. Chairman. It is a pleasure this morning for me to introduce to this committee two witnesses from my own district and my own hometown in Maine. Both of these gentlemen will describe the very interesting story of Bates Fabrics, Inc., and its adoption of an employee stock ownership plan [ESOP] in order to retain its position as Lewiston, Maine's, largest employer.

Representing Bates Fabrics will be Raymond St. Pierre, vice president and treasurer of the company. Mr. St. Pierre has been associated with Bates for approximately 25 years and will certainly be able to speak about the many changes undergone by the company during his career. As well, Mr. St. Pierre is a director of the company, sits on the ESOP governing board, and will be able to address questions concerning the effect of ESOP upon the operations of the company.

Representing the Lewiston area will be John Turner, the executive director of the Lewiston Economic Growth Council. This organization, funded in part by the city of Lewiston, is concerned with the economic health of the Lewiston area. I expected that Mr. Turner will be able to illustrate the importance of Bates Fabrics to Lewiston, Maine. I look for his testimony to show us just how important efforts to save companies like Bates Fabrics can be.

Mr. Chairman, before our two witnesses begin their testimony, I would like to note for the record that Mr. Dennis Blais, Maine's representative with the Amalgamated Clothing & Textile Workers Union, was also invited to participate here this morning. Mr. Blais, besides representing the work force at Bates Fabrics, has also been intimately involved in the transitions undergone by Bates Co. I am certain he would have been an excellent witness. However, pressing union business has made it impossible for him to attend today.

Also, the national office of the Amalgamated Clothing & Textile Workers Union has promised my staff that any questions that members of the subcommittee may have that normally would have been addressed by Mr. Blais will be answered in writing and provided to the subcommittee staff.

Thank you, Mr. Chairman, for allowing me to introduce my two witnesses here today. I am glad that you could take the time out from your own schedules to come here to Washington to testify. I am looking forward to your testimony.

You may proceed.

TESTIMONY OF RAYMOND ST. PIERRE, VICE PRESIDENT AND TREASURER, BATES FABRICS, INC.

Mr. St. Pierre. I would like to thank the committee and its members for the opportunity to present the following on behalf of Bates.

Bates Fabrics, Inc., is located in an urban area of Lewiston, Maine. Lewiston is the second largest city in Maine, with a population of slightly over 40,000 people.

Bates is a fully integrated manufacturer of textiles, namely woven bedspreads, matching drapes, and fashion table covers. The company was founded in 1850 as Bates Manufacturing Co., and the first bedspread woven locally was made in 1858. Bates remained a major factor in the textile industry all through its long history, and at one point in time operated a total of 5 mills in Maine with a total employment of over 6,000 employees.

Bates Fabrics, Inc., is vertically integrated and starts its process from raw cotton and synthetic fibers and manufactures a finished product in its 1,200,000-square-foot plant in Lewiston.

Bates also produces all of its power needs through a system of canals which feeds into its three hydroelectric generating plants.

The bedspreads manufactured are sold nationally from selling offices and distribution centers maintained in major cities throughout the United States. About 10 percent of all bedspeads sold nationally and over 25 percent of all woven bedspreads sold are manufactured by Bates.

Our company's products are well known to the American consumer for the traditional patterns and durable fabrics. Bates was the pioneer in colonial style bedspreads with the introduction of its famous George Washington Choice in 1940. It also produces Colonial Williamsburg reproductions in addition to more traditional styles of woven and quilted bedspreads.

Bates bedspreads are distributed to consumers through three markets: one, retail stores and major department stores; two, institutional market of hotels, motels, and hospitals; three, mass merchandisers such as chainstores, discount houses and stampstores. While present sales are drawn about equally from each market, the greatest growth has occurred in the mass merchandise market.

In 1972, Bates introduced its House of Windsor line which was directed to appeal to mass merchandisers such as catalog houses, discount stores, and downstairs units of conventional department stores.

Although the company has primarily sold in the domestic market, export potential is presently receiving serious study.

In 1979, the sales of Bates exceeded just over $27 million. This represented a 9-percent growth factor. The company presently employs 960 people with an annual payroll in excess of $10 million.

In 1965, Windsor Industries, Inc., a Delaware corporation, acquired Bates Manufacturing Co.'s three Maine textile firms: the Edwards Division in Augusta, and the Hill and Bates Divisions in Lewiston. The new corporation took the name Bates Manufacturing Co. after its best known enterprise and became a holding company for several textile and apparel firms, most of which were located in the Southern United States. They were: Royal-O-Apparel of High Point, N.C.; Castlecreek Fabrics, Inc. of Washington, N.J.; and Sweet-Orr and Co., sole manufacturer of Boy Scout uniforms, of Dawsonville, Ga., and Pulaski, Va.

Before acquiring Bates Fabrics, the parent company was involved solely in textiles and apparel. In 1967, however, Bates Manufacturing began to diversify its holdings. It purchased 45 percent of the common stock of the Virginia Iron, Coal & Coke Co. and bought Condata System, Inc., a computer concern.

In the late 1960's, many apparel firms were experiencing difficulties due to the rapid changes in market demand and competition from foreign imports. Included among these apparel firms were several divisions of Bates Manufacturing Co. Because of these general market conditions and the higher return to be made in the energy field, Bates Manufacturing gradually began to sell or liquidate its textile concerns at this time.

Along with several Southern concerns owned by Bates Manufacturing, the Hill and Edwards Divisions of Bates Fabrics were phased out of production: the Hill Division in Lewiston in 1970, and the Edwards Division in Augusta in 1972. Assets of these two firms were either sold outright or transferred to other divisions.

Because of this shift in its concerns from textiles to energy, Bates Manufacturing also became interested in selling Bates Fabrics, a wholly owned subsidiary with a comparatively low—7 percent—rate of return.

In 1975 the management of Bates Fabrics was informed that Bates Manufacturing Co. wanted to divest itself of its home furnishing operations and was placing the company up for sale. Bates Fabrics competitors appeared interested in acquiring the company for its trademark and its established sales and distribution system. The threat that Bates Fabrics would be sold and that its manufacturing facilities be moved became a reality.

It was at this point that the management of Bates began to consider ways in which the ownership of the home furnishing operation could be accomplished.

At that time there was considerable publicity being given to employee stock ownership plans. Because of the stabilizing effect of ERISA on employee benefit plans and the potential tax savings effects of ESOP, it was determined by the management of Bates that, if it were able to negotiate a fair purchase price for the company and proper financing could be obtained, the use of an ESOP as a financing vehicle could be ideally suited as a means for the acquisition of Bates as an alternative to its sale to a third party.

Having decided to proceed with the goal of acquiring Bates Fabrics through an ESOP, the management of Bates proceeded to seek a lending institution to assist in the financing and also began negotiations with the parent on a purchase price. This activity spanned a total 1½ years before the acquisition was accomplished on December 31, 1976.

This transaction was finalized with the establishment of an ESOP along with the borrowing of $8 million from the First National Bank of Boston, a loan which was 90 percent guaranteed by the Farmers Mutual Home Administration.

The management of Bates feels that the benefits to the company and its employees as a result of the acquisition of the company were:

One, future management decisions would be made in Lewiston for the benefit of Bates and its employees as opposed to an absentee management.

Two, employees were given job security. The threat that the company would be moved was dispelled once and for all. Such rumors were prevalent for years, perhaps as a result of the continuous selling off and liquidation of local textile properties.

Three, the management could exercise a plan to modernize the local facilities by purchasing advanced technology equipment to improve its production. During the 5 years prior to the acquisition of Bates, only slightly more than $200,000 had been spent annually for acquisition of new equipment which amounted to only about 60 percent of its annual depreciation. During the last 3 years, Bates has committed itself to the purchase of $1.7 million in new equipment and plant improvements.

Four, the establishment of the ESOP would ultimately benefit all of the Bates employees by supplementing the pension benefits upon retirement while allowing them to share in the equity.

Five, through the cooperation of Lewiston Community Enterprises, a quasi-municipal organization, Bates was able to reacquire the land and buildings it occupies which was previously sold and leased back. The land and buildings were acquired for $200,000, which is substantially less than appraised value.

During these formative years, the management of Bates has endeavored to inform all the employees about the benefits of an ESOP. This has been done through the issuance of employee booklets and a company house organ which was reintroduced.

The company has furnished all the employees with quarterly and annual financial reports to keep them abreast of the financial condition of their company.

For the first 2 years, a total of 73,556 shares have been allocated to employees accounts, and 32 employees have retired and have been issued an average of 50 shares each. Of these, nine employees have sold their shares back to the ESOP.

Bates has recently established an employee council. The council is made up of a cross-section of Bates employees. Its purpose is to give all employees some means to assist management of their company by offering suggestions to the board of directors for the betterment of Bates.

Since the ESOP was established, employee attitude has generally been good. However, since the production employees are represented 100 percent by Amalgamated Textile Workers Union, there still continues to be a union-management relationship.

We find that the often-touted benefits of an ESOP such as improved productivity and improved employee turnover have not materialized.

Speaking for Bates management, it is generally felt that the employees will not truly appreciate all of the benefits of an ESOP until sometime in the future when he or she retires and take with them stock which represents a substantial value to the employee.

Thank you. I would be happy to answer any questions you may have.

Mr. BEDELL. Mr. Turner?

TESTIMONY OF JOHN C. TURNER, EXECUTIVE DIRECTOR, LEWISTON ECONOMIC GROWTH COUNCIL, LEWISTON, MAINE

Mr. TURNER. Mr. Chairman and members of the Subcommittee on Antitrust and Restraint of Trade Activities Relating to Small Business, my name is John C. Turner, executive director of the Lewiston Economic Growth Council of Lewiston, Maine. I would like to take this opportunity to thank you and especially Representative Olympia Snowe of Maine's Second District for the opportunity to appear before you today on behalf of the city of Lewiston.

The Lewiston experience as being a one-industry town is not unique for the most part. It is a story of a city living under the pressure of losing its economic backbone at the suggestion of someone in a faraway boardroom.

The Lewiston experience, however, did become unique on Friday, December 31, 1976, when Bates Fabrics, Inc., became one of the first 100 percent employee-owned companies in the United States under the employee stock option trust program.

That date marked the end of one era and the beginning of another not only for the employees of Bates Fabrics but also for the city of Lewiston.

For the first time in over 30 years, city government was assured that Bates, the city's largest employer, would enter into a period of long-term operation without the constant threat of being shut down, leaving the city to deal with over 1,200 lost jobs and the loss of an annual payroll in excess of $9 million, not to mention the loss in tax revenues.

The December 31, 1976, date also marked the end of job uncertainty for an entire generation of Bates Fabrics' employees, especially the older people who were nearing retirement ago. For those citizens, the employee stock option plan not only meant job security for the remainder of their working years but also meant the opportunity to collect deserved pension plans resulting in security for the twilight years of their lives.

During that period, officials of the city of Lewiston spent seemingly insurmountable amounts of time and effort toward insuring Bates Fabrics would remain in Lewiston. During that period, city officials were keenly aware that equipment in the mill was not being updated and that productivity was remaining stagnant as a result. This, they knew, was occurring while inflation added more and more cost on raw materials and energy, resulting in lower profits to the parent company.

City officials were also casting a worried eye to the South, where the textile industry was in the process of constructing new and more efficient plants utilizing labor that was being paid even lower wages than in Lewiston, Maine, and that they were located close to the raw materials utilized by the industry.

City officials had to be blind not to have noticed that Bates Fabrics' parent company was diversifying into other areas that showed—and I quote—"higher profit ratios."

And, with all of this in mind, it was with great deal of difficulty that city officials had to accept the fact that any closing order would be made in another city, in another State, by people looking at a set of numbers with little or no input, or personal feelings, toward the employees of Bates Mill and city residents who had made such a determined effort at retaining the company in Lewiston.

Since December 31, 1976, things have changed. Not only do employees of Bates have job security, but also city officials have a secure feeling that the worst is over and that future decisions will be made by local people who have a stake in Bates' survival and a stake in the community.

City officials can look at the tax records and see that valuations of equipment at Bates are increasing and the resulting real estate and personal property taxes being paid the city are on the rise.

The economic base of Lewiston has diversified tremendously during the past 3 years as a solid long-term program of development, both commercial and industrial, has emerged.

During that 3-year period, city officials, working with the knowledge that Lewiston can never again be so dependent on one company, have established strong business retention and outreach programs seeking to accommodate expanding industries from within and from outside the area.

The employee stock option program at Bates Fabrics indeed put an end to one period and ushered in another of stability. Bates Fabrics has, and continues to be, the backbone of Lewiston's industrial base. The company is still the city's largest employer today and provides income for hundreds of Lewiston and area families.

The dependency of the city on the company—and for a majority of years Bates has existed in Lewiston with its dependency on the city's highly skilled and dedicated workers—went through many trying periods.

It is our belief the dependency on each other still exists to a degree. However, the relationship is far more stable and the dialog far less acrimonious.

We have nothing but praise for ESOP and what it has meant for the city of Lewiston. We knew, only too well, alternatives to the ESOP program.

The city was aware of what the sale of the plant to another party would have meant, or what the sale of the prized Bates trademark would have meant. In both cases, Lewiston and Bates employees would have been the losers.

Bates Fabrics of New York is to be congratulated for allowing the sale of the plants to its employees. We feel that one factor has had a dramatic effect on Lewiston as we know it today and what it will be like tomorrow.

Again, we would like to thank the committee for allowing us to appear before you today. I will be happy to answer any questions.

Mr. **Bedell.** Thank you.

Mrs. Snowe?

Mrs. **Snowe.** Thank you, Mr. Chairman. I guess we can all agree it is nice to hear a success story. I can say, too, that I was not entirely familiar with the way that Bates made the transition. I can also attest to the fact that Lewiston, Maine, as a result of the Bates experience, has certainly diversified its economic base and has done very well.

I thank you very much for your testimony this morning.

I am very much interested in this ESOP program and how it came about. Could you explain to the committee when you first began to consider alternatives in ways to approach the management and purchasing the Bates Manufacturing, where did you go first? Did you go to the Federal Government? Did you go to EDA, SBA, the Farmers Home? Did you go to the city of Lewiston? And what were your responses by these individual agencies?

Mr. **St. Pierre.** First of all, the first decision that was made was whether it was feasible to purchase the company under the ESOP. The tax breaks afforded by the ESOP were perhaps the largest consideration because Bates would be able to finance the loan through contributions which could be made to the ESOP and which are presently being made.

Once it became practical to use the ESOP as a vehicle, as I indicated, we started to look for financial institutions. We approached a large local bank as the first means of acquiring money. It became readily apparent that we could not get a term loan of sufficient length to be able to make the whole thing work because the contributions that we would make to the ESOP would have to be done over a long period of years. After consulting with the bank that I mentioned, it was determined that the only approach that we could take was perhaps through some agency of the Federal Government, at which time two agencies were considered by the management as those likely to be approached. One was the EDA and the Farmers Mutual Home Administration.

The EDA was——

Mr. **Bedell.** I am acquainted with the Farmers Home Administration. Is the Farmers Mutual Home something different?

Mr. **St. Pierre.** It is the same thing. It is just that they try to differentiate between FHA and FMHA because of the various programs that they have.

This is the Department of Agriculture, and it is the business and industries division of the Department of Agriculture.

Mr. **Bedell.** Thank you.

Mr. **St. Pierre.** We soon found that the EDA would not consider our needs at the time because there was still not this threat that Bates would be leaving Lewiston, even if it was sold to a third party. So, then we approach the Farmers Mutual Home Administration because we heard about their program. The only criteria that they had at the time was that jobs in rural communities—it was to secure jobs in rural communities. Rural communities were defined as areas with population of less than 50,000.

We approached the Farmers Mutual Home Administration and interested them in perhaps helping us to finance, which ultimately they did.

Mrs. **Snowe.** At the time, you were reasonably assured that Bates would be moving south, that they would be liquidating or that they would be closing down or selling out? Were you both reasonably assured?

Mr. **Turner.** Looking through the files, there is no doubt in my bureaucratic mind that they would definitely have been gone.

Mrs. **Snowe.** And that was your feeling, Ray?

Mr. **St. Pierre.** That was my feeling; yes. We were approached by one national company that was in textiles. They had hundreds of plants throughout the United States. From our discussions with them with regard to their possible purchase of Bates, it came to light that they were not really interested in the manufacturing facilities as such. They were a big supplier of one of the major catalog houses in the United States. They did not have access to a national market the way we did through our sales force. To me it became apparent that they were looking at Bates, No. 1, for its trademark and to use its distribution and selling facilities.

Mrs. **Snowe.** Would you agree then—I have a couple of questions. Did your group, when you approached the management of the parent company with an offer, were there other offers being made? There was a leadtime of about 18 months between the time you began and the time you concluded. Did other companies make offers? Or was yours the sole bidder?

Mr. **St. Pierre.** I can only assume that there was because there were two companies that came to Bates to visit the complex. However, negotiations were being carried on with the parent company.

I don't know that they ultimately resulted in an offer. I am reasonably sure that they did.

In the instance of the last company, the other company I mentioned, which was the catalog house, they were finally turned down because we finally reached an agreement with the parent to buy. So, we called them up and told them that the parent was no longer interested in any offer they might make. But I know there was one other offer besides the one that presumably would have resulted from further negotiations.

Mrs. **Snowe**. Was your offer a much more attractive offer because of what the Federal Government did? I understand that the Federal Government assumed tax expenditures and also tax writeoffs for the parent company when you made your purchase.

Mr. **St. Pierre**. Yes.

Mrs. **Snowe**. Do you think that that was helpful in facilitating this transaction?

Mr. **St. Pierre**. Well, I don't have any doubt that—well, I don't know what the offers might have been. But I am sure that—they must have had a purpose to want to sell to the Bates Fabrics, the purpose being that I think they felt a little guilty about wanting to close the plant down; and they felt a corporate obligation.

They may have gotten more out of it than they probably would have if it had gone to the market. I don't know.

Mrs. **Snowe**. Just to inform the committee, I understand that the Federal Government bore the cost of $363,000 annually in tax expenditures. Also, the Federal Government assumed $572,000 in tax revenues as a tax writeoff for the parent company. So, that may have been an additional attractiveness for the parent company to go to this option rather than another option.

Mr. **Bedell**. I presume that tax writeoff would have applied however they sold it. Would it not? Or do you know?

Mr. **St. Pierre**. Yes; it would have.

Mr. **Bedell**. If they sold it to you or somebody else, they would have still had that tax writeoff.

Mr. **St. Pierre**. Or someone else.

The book value of the company at the time was $10.5 million, and they sold it for $8 million. So, there was a $2.5 million writeoff that was available to them whether they sold it to us or sold it to someone else.

Mrs. **Snowe**. Legal costs and the loan guarantee from the Farmers Home.

Mr. **St. Pierre**. What was your question?

Mrs. **Snowe**. The writeoffs were the loan guarantee from Farmers Home. That is one of the writeoffs, as I understand it.

Mr. **St. Pierre**. No. The writeoff would have been the book value that the parent company had.

Mrs. **Snowe**. OK, in the memo that was done by——

Mr. **Levine**. That memo was put together by a college class in Boston, Mass. It is background on the case.

Mrs. **Snowe**. That is right. Well, is it correct or incorrect?

Mr. **Levine**. I think it is correct in that——

Mrs. **Snowe**. Let me read the statement in part: "tax revenues associated with the parent company's writeoff of legal costs and the Farmers Home Administration loan guarantee fee."

Mr. St. Pierre. Yes; the fee.

Mrs. Snowe. The parent corporation also benefited from the substantial tax shelter resulting from the sale base of $2.5 million below book value.

Mr. St. Pierre. As I mentioned, the book value was $10.5 million and sold it for 8.

Mrs. Snowe. Right. So, they got that writeoff.

Mr. St. Pierre. So, they got a $2.5 million writeoff for tax purposes.

In addition to that, when the company decided to divest itself and we approached them with the offer to form the ESOP, they indicated to us: Fine, we feel we have a corporate obligation, and we will pick up all of the legal fees and other fees associated with the possible sale to the employees.

I think that amounted to about $750,000 all together, which also included, I think, a 1-percent commitment fee that was made to the Farmers Mutual Home Administration of $80,000, which was paid on the front end.

Mrs. Snowe. What specific role did the city of Lewiston play, from what you can ascertain?

Mr. Turner. Over a long period of time, they were involved in keeping the company as comfortable as possible. In 1964, city officials and local business leaders formed the Lewiston Community Enterprise, Inc., which is a corporation formed solely to deal with Bates Fibers. At that time, they purchased the land and buildings that Bates has now as we know it today and leased it back to Bates over a long-term lease program at, toward the end, 10 cents a square foot. So, they were subsidizing, in a sense, the building. Also, they were involved in assisting the company put together the sewage treatment plant and repairs to the building. At the end, it is kind of ironic; they bought the building and land in 1964 to keep the company in Lewiston, and in 1976 they sold the same building and land back to the company so that they would stay in the city.

During that period of time, the problem as existed, in talking with a lot of people, was the constant threat that they would be gone within a very short period of time. Rumors started from the basement of the building at Bates that the company was going to close. Within a day it was in the newspapers; you know, that type of thing.

So, we are talking about an entire generation of people we know that were living under that constant threat.

Mrs. Snowe. Did the city purchase the buildings as part of the agreement?

Mr. Turner. The Lewiston Community Enterprise, Inc., purchased the building back in 1964.

Mrs. Snowe. Was that to facilitate the acquisition by the employees?

Mr. Turner. No; that was to provide the parent company with a substantial tax writeoff, and also they would be leasing the building for a very low sum of money. During that period, the city was the driving force behind the Community Enterprises, Inc.

Mr. St. Pierre. I think probably that was the first step in the eventual divesting of the parent of its textile operation in Lewiston. The phrase was at the time: We don't want to own any bricks and mortars—you know, putting them in a position where, if they wanted to move out, it would facilitate doing so.

Mr. **Bedell.** Was the purpose of that that they sold the building to the city at significantly below the book value they had on it to give them a writeoff, and the city had it at a low cost? Is that what happened?

Mr. **St. Pierre.** Yes; I would say yes to that.

Mr. **Turner.** When the Community Enterprises, Inc., resold the building back to the ESOP program, they took a substantial loss. The Community Enterprises, Inc., took the loss. But I think the timing was right. It was a loss in dollars, but it was a gain in every other way.

Mr. **Bedell.** What did they sell it for per square foot?

Mr. **Turner.** It was $200,000 for the total plant. That is 1,200,000 square feet.

It was a substantial commitment by the Community Enterprises, Inc.

Mrs. **Snowe.** I have one final question with respect to ESOP. Did the employees and the management own the same amount of shares? How does that work? I am not familiar with that.

Mr. **St. Pierre.** As it is, the securities are all pledged as collateral for the loan. The securities are in the hand of a trustee, which is a local banking institution. As the loan is paid back, as the equity is paid down on an annual basis, a portion of the shares that have been pledged as collateral are released to the company. Under the terms of the plan, those shares are then allocated to employees. They are put into an employees account.

They are distributed on the basis of W-2 wages. It is a fraction of each individual's wages to the total wages for the year times the number of shares that are available for distribution.

Mrs. **Snowe.** Thank you very much. I appreciate it.

Mr. **Turner.** I would like to make one statement. I think the base as we know it today is successful because of a few reasons. Number one is the continuity of good, sound management and the ability of management to make changes technically and within the concepts of sales and what have you, and also the willingness of the city and the State and especially the Federal Government in providing loan guarantees so that they can update their equipment. So, I think it is a combination of several factors that makes this ESOP program successful, not the least of which would be a good, sound management program.

Mrs. **Snowe.** Thank you.

Mr. **Bedell.** Mr. Tauke?

Mr. **Tauke.** Mr. St. Pierre, you anticipated my question. First of all, though, I want to know how successful is the new company? Are you making a profit?

Mr. **St. Pierre.** We have operated profitably since the establishment of these.

Mr. **Tauke.** What kind of return are you getting on investment now?

Mr. **St. Pierre.** At this point we are just about breaking even as far as our ability to pay off interest on debts and also making contributions to the ESOP. But the contributions are quite sizable;

and it is generally felt that, if management can continue to do that, it is successful.

The annual payback on the loan amount in excess of slightly over $900,000 a year.

Mr. BEDELL. Are the contributions to ESOP, in effect, contributions that go to pay off the amount of the loan in the final analysis?

Mr. ST. PIERRE. The greatest part of them; yes. A certain amount of the contributions is used to repurchase stocks that have been issued to employees that have retired. But the majority of the contributions are used to pay back the loan; yes.

Mr. BEDELL. So it decreases, then, your obligation there?

Mr. ST. PIERRE. Yes.

Mr. BEDELL. Could you tell us about how much your annual contributions have been in that regard?

Mr. ST. PIERRE. About $906,000 a year.

Mr. BEDELL. That is sizable then.

Mr. TAUKE. How do you determine how much your contribution will be?

Mr. ST. PIERRE. We make contributions in sufficient quantities to amoritize the debt. It would be unwise to do any more because the money is needed in the business itself to purchase new equipment and so forth. So, we limit the contributions to the actual amortization of the debt plus the amounts needed for repurchase of the stock.

Mr. TAUKE. I am not certain I understand this whole procedure.

Mr. BEDELL. I think I do. If this were a normal business, operating normally with that structure, which is a very heavy debt structure, you would be making the profits necessary to pay the interest on your debt. You would also be making a pretax profit on the order of $900,000.

Mr. ST. PIERRE. Yes.

Mr. BEDELL. Which in this case, instead of giving to stockholders or holding in the business, you are using to pay off the total of $8 million.

Mr. ST. PIERRE. That is right.

Mr. BEDELL. In effect, however, in paying it off, that money is really going to the employees because it says that they own that much more of the business. Is that it?

Mr. ST. PIERRE. Yes; that is it exactly.

Mr. TAUKE. So, the total value of the business as you purchased it was about $8 million. Is that what you have invested?

Mr. ST. PIERRE. Well, we purchased the stock actually. But the value of all of the assets that are represented by the stock is still approximately $10.5 million.

Mr. TAUKE. Let's say the investment is $8 million.

Mr. ST. PIERRE. Yes; that is right.

Mr. TAUKE. So, you are getting, in a sense, over 10 percent return on the investment.

Mr. ST. PIERRE. Yes.

Mr. TAUKE. How is it that you can make the company go with the 10- or 12-percent return and the parent company, which was Bates Manufacturing, was not able to make a profit or was having trouble making a decent profit anyway, a decent return?

Mr. **St. Pierre.** Well, I think that their requirements were somewhat higher than what we require. We might be satisfied with a return that would amortize the debt, and they would not be. Where they were getting perhaps a 20-percent return in the coal business, even 7 or 10 percent would not be attractive to them.

But I think that ultimately, going back over the years and looking to see what has happened, regardless, they would have divested themselves of all the textile operations anyway because I think ultimately they were more interested in making money. Eventually, they divested themselves of the coal business, too. That was recently sold, and Bates Manufacturing Co. is presently in the process of liquidating the holding company.

Mr. **Bedell.** I think there is a further explanation. The $900,000 that you used to pay back on your loan, which is really in a sense profit, is not taxable. I think I am correct on that.

Mr. **St. Pierre.** Yes; that is right.

Mr. **Bedell.** Whereas, if the Bates Co. were owned by some other corporation and they make $900,000 pretax, they would probably have something like $500,000 after tax profit, which on an $8 million——

Mr. **St. Pierre.** The company is allowed under the ESOP regulations to make contributions equal to about 15 percent of its annual payroll tax free.

Mr. **Tauke.** This was exactly the point I was driving at. That is that, really, what is happening is the Federal Government is, in a sense—and I am not saying this critically—providing a $500,000 subsidy a year to the company.

Mr. **St. Pierre.** The Federal Government is today. But what it really is doing is, it is postponing the tax that is going to be paid to the Federal Government. As the employees retire and get that stock, then it becomes fully taxable to them.

Mr. **Tauke.** But certainly the tax rates will not be nearly as high.

Mr. **St. Pierre.** I am sure they will not be.

Mr. **Tauke.** So, in a sense, the Federal Government is providing great incentives. Perhaps it is because of those incentives that the company is able to continue to operate.

Mr. **St. Pierre.** Absolutely.

Mr. **Tauke.** Then the question comes—and maybe this is in the macroeconomics sense of the economy of the country—is it good economics? Is it good economics, in your judgment, for the Federal Government to pursue a policy of perhaps propping up or maintaining industries or companies that really are not able to compete fairly in the marketplace? Is that good economic sense? Or do we justify it solely on the basis that it makes good social sense to keep small communities alive and keep a community like yours thriving and people employed and so on?

Mr. **St. Pierre.** Well, talking to me, I would have to answer that it makes good sense to the city of Lewiston and it makes good sense to the 900 and some odd people that retain their jobs.

In the other instance, if those people were not working, then they would be drawing unemployment. They would not be paying Federal income taxes on the wages that they are making. So, besides the benefits that are derived by the community, there are certain benefits derived by the Federal Government in the fact that you have able, competent people that socially hold their heads high in the community because they are paying taxes and do not have to stand in line for unemployment compensation.

Mrs. **Snowe**. Just to comment on that point, I think it is not unusual Federal policy for them to engage in leveraging loans and working capital for a company. I mean, we provide money for UDAG grants and that sort of thing so that we can attract industries to locate and renovate in areas so that more businesses would expand or improve their own facilities. In this case, I think it is just to provide the employees of the company some working capital with which to finance their operation. It is a tax benefit of sorts temporarily, but it is not unusual Federal policy in many respects, as we have certainly seen with the Chrysler loan guarantee program.

Mr. **Tauke**. Which I voted against.

I agree it is not unusual Federal policy, and I think it is probably good Federal policy. I certainly prefer this to public service employment, for example. But I think a market purist—and I do not say this critically but just as an observation—would say: We are not going to have the proper turnover in our economy if we continue to pursue these kinds of policies of keeping in business industries which would have gone out of business if normal market forces had gone to work. If you pursue a policy where you keep in business companies that cannot make it in the regular marketplace, then you tend to stagnate the economy, and you do not have the movement in the economy that is necessary.

Now, I am not saying that I necessarily buy that point of view, but I do think that it is an observation.

Mr. **St. Pierre**. I do not think that we have said anything that indicated that this company could not make it in the marketplace. Although it was sold, it was a viable concern with a very, very attractive products to sell and perhaps one of the largest bedspread manufacturers in the country.

Mr. **Tauke**. But, if you are getting a return on your investment of, let's say, 5 percent at a time when inflation is running at 12, 13, or 14 percent and you can invest your dollars in Federal Treasury notes and get a 13-percent return with no risk, I would say you are going to have a tough time attracting investors with a 5-percent return; and your future is not very attractive. You are not going to be able to make it in the marketplace.

I should not be doing this because I really like what you did.

I guess those are all the questions that I have. It is an interesting experiment. I am not certain I understand totally how these plans work, but I think it is certainly something that this committee should look into. Thank you.

Mr. **Bedell**. If we could talk a little bit about this situation. I have been extremely interested in ESOP plans. I have done quite a lot of looking into them.

We are talking partly about a social problem. The real attraction of ESOP plans is—the question is, who should receive the rewards for the work that is done? We have a society in which we say that the rewards should go to those who provide the capital and the workers who furnish the work should get wages for their work, but the profits go to those people who supply the capital.

The problem we have in our society is as we become more and more capital intensive, we come to where we have more and more automation. Then we come to the place where a greater percentage of the earnings would normally accrue to those who supply the capital. We use all sorts of methods in order to see that this does not get too far out of line. Those people who are promoting the ESOP proposal say, if the capital is owned by the workers rather than the outside investors, then the people who do the work are more equitably going to share in the returns of their labor.

The argument is made that labor is becoming more productive and the reason labor is becoming more productive is simply because they are using more capital. So, we give them credit for some of the capital that is used simply in order to bring some equity to our society.

For example, if you have two elevators and two elevator operators, and you can automate one of the elevators so that you only have one elevator operator. Then we say that that operator is doing twice as much work and is twice as productive. Really, the operator is not doing anything differently than before. But in our industrial complex we say we are going to pay them more because their productivity has increased.

If we continue the trend in most societies where capital is owned by outside investors and the profit accrues to them so they can obtain more and more capital, you end up with certain individuals owning more and more of the total productive capability of this society.

I think the purpose of ESOP is to counter that trend.

Mr. Tauke. If the chairman will yield. I think that is a good purpose. But perhaps what I was suggesting is that it is more difficult, I believe, to justify ESOP on the basis of economics than it is to justify it on the basis of what kind of society would you like. Certainly, one of the difficulties we have today, at least as I see it economically, is our inability to make the investment of capital a profitable thing. There is no incentive for individuals to invest in businesses and industries. That is why they are buying instead antiques and gold and things that theoretically they are going to be able to get a better return on.

Mr. Bedell. Which compounds the problem I mentioned. The only way that capital is generated is by the capital itself generating more—rather than having an attractive investment for people who might have capital of their own to invest. So, it really compounds the problem.

I guess the problem I have is this. We have had a lot of testimony today that some of the companies with new management have not been properly managed. What would happen if the people who are managing Bates under an ESOP plan were not properly managing the company? If it was going downhill, how are you organized to make changes? Who would make it and how would it operate?

Mr. St. Pierre. We operate similar to any corporation.

Mr. Bedell. Who are on the board?

Mr. St. Pierre. The board of directors are the president of the company. I am on the board of directors. We have a couple of other in-house directors. We have three outside directors who are prominent businessmen in the city of Lewiston.

Mrs. Snowe. Who elects the board?

Mr. St. Pierre. The council or the committee of the ESOP, which is made up of three members.

Mr. Bedell. Who are they?

Mr. St. Pierre. They are myself, Mr. Irwin Berg——

Mr. Bedell. Who is he?

Mr. St. Pierre. He is a controller of the company.

And one outside member, Mr. William Randall, who is a local certified public accountant.

Mr. Bedell. You understand the problem I see here. If you and the other gentlemen who make up that council were not doing your job properly, you are two of the three that really make the decision as to who is going to be the board, and the board is the group that decides whether you should be fired or continued. It appears that this is a serious problem in ESOP. If you were not managing it correctly, my guess is that you would be one of the last to realize it. Normally that is the case, we tend to think we are doing all right.

The concern I have about ESOP plans is to see that they are organized in a manner that will enable them to make the changes that might be necessary if things are not going correctly.

Do you have an answer to that concern?

Mr. St. Pierre. In this instance we would hope that a sufficient number of outside board members would have a realistic approach to what is happening to the management of the company.

Mr. Bedell. Maybe, but board members sometimes are hesitant to fire the people who are responsible for their appointment to the board.

Mr. St. Pierre. I think that, if you knew our board—you know——

Mr. Bedell. I do not know your board. I am saying the problem that I have with ESOP is how you set it up. Frequently, workers themselves do not have the expertise to know whether it is being run properly or not. I am concerned about how you establish that control in an ESOP plan.

Yours is working great. I think it would just be tremendous if we had a society where the workers owned the capital, and received the benefits of the productivity that resulted from this ownership.

I think we are headed for trouble as we become more and more automated. The fact of the matter is that the labor component becomes less and less of the total component.

We got off into some philosophy here.

Mr. Tauke. Do the employees run a risk on their investment in some way?

Mr. St. Pierre. There is no investment by any of the employees.

Mr. Tauke. So, there really is no risk except that, if the company would go down the tubes, they would not have any benefits under the plan?

Mr. St. Pierre. All the employees are covered by a pension plan. But, should something happen to the company, that the company should not be successful, then you would have the position of just delaying something that could have happened 2 or 3 years ago.

Mr. BEDELL. There is no risk at the beginning. But, as you move forward, then the employees own more and more of the company. Then, if the company were to go broke, they would lose what they had gained through their ownership in the company. The time could come when your banks would be all paid off and the employees indeed would own $8 million, or whatever the worth of the stock of the company.

Mr. TAUKE. If I were an employee for 10 years in the company, could I then sell my portion of the company?

Mr. ST. PIERRE. No. You would not get your stock issued to you until you retired at normal retirement age.

Mr. TAUKE. So, if my stock would be what my share would theoretically be worth, $5,000, I cannot go out in the market and sell that. I have to wait until I retire before I could do that.

Mr. ST. PIERRE. That is right.

Mr. BEDELL. What if you leave the company?

Mr. ST. PIERRE. You have your vested rights, the same as you would in a pension plan. It is a 4–40 type of vesting. After 4 years, you get 40 percent and up to full vesting after 10 years.

Mr. BEDELL. Is the legislation we are passing going to change that or not? Do you know?

Mr. ST. PIERRE. No. You know, there are several ways that you can vest the pension plan: an outright 10-year vesting or——

Mr. BEDELL. And that is not being changed by legislation that is being——

Mr. ST. PIERRE. No; it is not. The plan has been approved by the Internal Revenue.

Mr. BEDELL. Are there further questions?

I guess we are delighted we could end the session today with something that is on a cheery note.

My main observation would be that, first of all, you have done a great job. But, mostly, I think you are just luckier than heck. I think you are lucky that Bates Manufacturing happened to be the group that acquired your business and was interested in trying to help see that it stayed in the community. At least it appears to me that there is some possibility that if this had been a normal corporate decision, the decision might have been to liquidate the business or to sell it to somebody else to maximize profits.

It is kind of encouraging. I was not sure there were many companies like Bates Manufacturing that would look at something other than corporate profits.

Mrs. SNOWE. I think, Mr. Chairman, you are correct. I think inevitably the writing was on the wall that they were going to close it down. The competition from the South has indicated that with all the textile industries in the Northeast. So, I think we are very fortunate to retain it in the Lewiston area.

Mr. TURNER. Mr. Chairman, Mrs. Snowe brought out earlier that Arrow-Hart is in the process of leaving our town. We were notified 15 minutes before the employees that they would be picking up stakes and going. All the dialog in the world would not have changed that in 15 minutes. So, we have had a chance to work with

Bates for a long period of time, where this other company just made a decision to go.

Mr. **Bedell.** Your testimony indicated to me that the employees were not as excited about this ESOP plan as you would have expected them to be. Did I read your testimony correctly?

Mr. **St. Pierre.** Yes; you do. I think basically, where they are covered 100 percent by a union group and it is a closed shop, that all the employees come in and, of course, are represented by union; and the union will tell them, well, you don't own the company, it's the bank that owns the company.

But I think eventually that feeling may change as more of the stock is released and the value of the stock that the employees are allocated becomes substantially more.

Mr. **Bedell.** Well, they own the company the same as most of us own our homes. The banks own all of those things.

Mr. **St. Pierre.** That's right.

Mr. **Tauke.** Mr. Chairman, not to prolong unnecessarily but before we hand out lots of accolades to the parent company, did they get a good deal out of this in comparison to what they would have had if they had liquidated the company? Could they have gotten $8 million from somebody else if they had sold it? Or could have liquidated for $8 million or more?

Mr. **St. Pierre.** If they had liquidated—I really don't know. It's a question of value of the inventories and what they could have gotten for the inventories. Of course, they had a substantial amount of receivables which, presumably, were good receivables.

They could conceivably have gotten an $8 million return out of it through a combination of selling off of receivables and inventories and tax writeoffs.

Mr. **Tauke.** It occurs to me that maybe this is just another example of where a corporation made the decision that was in their financial best interest, which I suspect may be. And I do not criticize that. But it just is that the ESOP in this case was a good answer for the parent company as well as for your company.

Mrs. **Snowe.** Plus they gained the tax benefits regarding the ESOP program itself.[1]

Mr. **Bedell.** Thank you very much for your testimony. The hearing is adjourned.

[Whereupon, at 12:20 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

---

[1] Committee Note: See Appendix E for additional material re Bates Manufacturing ESOP.

blank page

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

FRIDAY, FEBRUARY 1, 1980

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2359-A, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. BEDELL. The subcommittee will come to order, please.

This is the second in a series of six hearings on the subject of conglomerate mergers and their effects on small businesses and local communities. Today is a continuation of our review of specific cases of acquisitions and divestitures by conglomerates.

The two cases we are examining today represent two very different situations.

One, the American Safety Razor Co., is a firm that was divested from a conglomerate parent and has since been able to continue operating quite successfully as an independent company.

The other, Youngstown Sheet & Tube, was held by one conglomerate, which was purchased by another conglomerate which ultimately shut down the firm. Probably no other merger in recent years has been the object of as much study as was Youngstown Sheet & Tube.

The American Safety Razor Co., is located in Staunton, Va., which is represented by Caldwell Butler. Congressman Butler served on this committee for many years. I am happy to welcome you back, Caldwell. It is a real pleasure to see you here, and I know how sincerely and actively you served on the Small Business Committee. Sometimes we didn't exactly agree, and I was especially aware of your effectiveness at those times.

So, we are glad to have you back here with us.

TESTIMONY OF HON. M. CALDWELL BUTLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. BUTLER. Thank you.

I am delighted to be here. I was privileged to serve on the committee while the American Safety Razor problem was developing in our district. I received fine help from the staff, and part of the success we hear about this morning, is as a result of what I was able to accomplish through the help of this Small Business Committee.

The witness I would introduce today is Mr. John Baker, chairman of the board and president of American Safety Razor since 1977. Prior to that he was president of the American Safety Razor Division of Philip Morris, which was located in Staunton. He also served as general manager of the Staunton operations and as vice president and general manager.

Prior to joining ASR, Mr. Baker had a broad experience as vice president of operations for Textron's electronic division. He held sales and marketing management positions with General Electric.

Mr. Baker is also a veteran of 15 years' service in the Navy. He presently holds the reserve rank of captain. He has a B.S. in mechanical engineering from Harvard and an M.S. in electrical engineering from the U.S. Navy postgraduate school.

He brings a great deal of professional experience and expertise to the American Safety Razor Co. In addition to that, he was very active in the negotiations which led to the creation and spinoff of this separate, locally owned corporation. If there is any one man who can be identified with the success, it is the effects and endeavors of John Baker.

I am pleased and proud to have the opportunity of presenting him to you today. [See Appendix F.]

Mr. **Bedell**. Thank you. We are glad to have you here. We have a practice of swearing in our witnesses here in this committee. If you would please stand and raise your right hand.

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Baker**. I do.

Mr. **Bedell**. Thank you.

You may proceed and either read your statement or summarize it as you wish, and we will enter your statement in the record.

TESTIMONY OF JOHN R. BAKER, PRESIDENT, AMERICAN SAFETY RAZOR CO., STAUNTON, VA.; ACCOMPANIED BY ARTHUR J. GAJARSA, ATTORNEY AT LAW

Mr. **Baker**. Thank you, Mr. Chairman.

And thank you, Congressman Butler, for that very nice introduction.

I would like to introduce the gentleman to my left, Arthur Gajarsa, of the law firm of Gajarsa, Liss & Conroy, counsel to American Safety Razor Co.

I am here today to outline the problems I encountered during the spinoff of the American Safety Razor Co. from Philip Morris. The American Safety Razor Co. is now, and was in the past, a viable company and a competitor in the razor blade business.

However, the circumstances surrounding the company's split with Philip Morris illustrate that, despite the viability of the company in the marketplace, financial support by a Government agency such as the Economic Development Administration, in union with private financing can be crucial to the continued existence of companies like ASR.

Philip Morris acquired the American Safety Razor Co. in 1960, apparently believing that its marketing expertise in cigarettes could be translated to razor products, and related health and beauty aids, and that they could build the business in direct competition with Gillette. They tried for several years with little or no success and then switched their attention to other areas—beer, real estate development, and so forth.

Although the blade business was, at times, marginally profitable, its relatively small size and lack of growth made it a poor fit with other large Philip Morris businesses. The decision was made to sell ASR and discussions were held with a very long list of customers over a period of many years, but nothing came of these talks until Philip Morris was approached by Bic in 1976.

In December 1976, an agreement was reached to sell the American Safety Razor Division to Bic Pen which is a subsidiary of Societe Bic, a French company.

In January 1977, the Federal Trade Commission indicated to Philip Morris, and to Bic, that it would oppose any acquisition by Bic of American Safety Razor Co. This position was taken notwithstanding Philip Morris' stated alternative of liquidating the company.

When the FTC maintained its position and filed action for injunctive relief, Philip Morris decided to liquidate ASR. From the point of view of Philip Morris, that was probably a sound financial decision. However, it was my feeling, and that of the senior management of ASR, that the company could remain profitable and continue to be a viable competitor in the razor market. More importantly, the company could continue as a vital economic factor in the community in which it is based.

As an alternative to liquidation, I met with ASR's senior management and examined the possibility of a management buy out. We received permission from Philip Morris to pursue this course, albeit, reluctantly.

Numerous meetings took place with local and out-of-State banks and several venture capital sources. It soon became apparent that financing from private sources was not possible and that assistance from Government agencies was our only hope.

With the assistance of Congressman Butler, we met with the Economic Development Administration of the Commerce Department here in Washington and in Philadelphia, the Farmers Home Administration in Richmond, and with several members of the Industrial Development Authority of Augusta County, Va.

A team approach was developed and, after several meetings with each of the agencies, the Industrial Development Authority of Augusta County was used as the vehicle to pursue the public financing.

We finally concluded our negotiations with Philip Morris in August 1977. The total acquisition cost was just under $17 million.

The key element in the financing was a $6 million loan from the Industrial Development Authority of Augusta County, Va., made possible by a grant from EDA under Title IX. The balance was financed by equity capital and bank loans. We closed the acquisition on September 30, 1977, about 6 months after the Federal Trade Commission's action.

Presently we have 700 employees in Augusta County. We have largely recovered from the long period of uncertainty resulting from Philip Morris' attempts to sell the company and the trauma of proposed liquidation. We are now profitable. We have experienced growth and anticipate more in the future.

For instance, we have introduced a disposable razor developed specifically for black men. We are developing and will shortly introduce several other new products. We have been able to do this because we had the assistance of public financing. Without it the company would have been liquidated and the employment in the community would have been further drastically reduced.

It is my recommendation to the committee that the statutory ability and authority of the Economic Development Administration and the Farmers Home Administration be expanded to allow for more expeditious treatment of applications such as ours.

They should have the ability to offer a commitment quickly. Time, in these situations, is usually very critical and it is essential that a continued cohesive partnership of Federal and State agencies and the private sector be fostered to deal with the unique financial problems encountered by smaller companies.

Thank you for the opportunity to appear before this committee and to present these remarks.

Mr. **Bedell**. Thank you very much, Mr. Baker.

When the Federal Trade Commission ruled that the company could not be sold, did you have any figures as to what the size of the company was in terms of market share at that time?

Mr. **Baker**. We had approximately somewhere between 10 and 14 percent of the razor blade market; depending on whether it is defined in terms of dollars or units.

Mr. **Bedell**. I assume that Bic had none?

Mr. **Baker**. Essentially no; a fraction of a percent. And Gillette had 60 percent.

Mr. **Bedell**. Gillette had 60 percent?

Mr. **Baker**. Yes.

Mr. **Bedell**. How could the Federal Trade Commission argue that when one company has 60 percent of a market, the one that had 14 percent couldn't be sold to one that had less than 1 percent, do you know?

Mr. **Baker**. Yes; I was present and listened to 2 long days of their reasons. They contested essentially that the No. 5 company should not be permitted to buy the No. 3 company in an industry, regardless of their relative market shares. And since there were only five companies that made Bic No. 5.

Mr. **Bedell**. To a layman it would seem that instead of helping bringing about competition it would hold back competition. If you have one company dominating 60 percent of the market, one's concern should be whether there is going to be competition for that large company. Is there something wrong with that thinking?

Mr. **Baker**. I agree with your thinking. It is completely obvious that Gillette dominates the market. Its dominance is demonstrated by the fact that even a larger company as Philip Morris could not effectively compete against them, and it is apparent from the financial reports that Bic is having an unsatisfactory performance, so that the real monopoly here is in Gillette.

Mr. BEDELL. Did the fact that Bic was a French company have anything to do with the decision?

Mr. BAKER. I don't believe so.

Mr. BEDELL. Was there any consideration given to the impact on the community or the social impact that would result by the closing?

Mr. BAKER. We discussed that particular problem at length——

Mr. BEDELL. With the FTC?

Mr. BAKER. With the FTC. In fact, many busloads of the community representatives and of the workers in the factory were at that time picketing outside the Federal Trade Commission trying to make that exact point; that this would be a very, very severe impact on the community. We already were in a condition of relatively high unemployment. We were a large employer in this area, and the liquidation of the company would have been disastrous for the community.

But they refused to consider the impact. They said that was, in effect, too bad.

Mr. BEDELL. Mr. Tauke, I should mention, to bring you up to date a little bit, Mr. Baker, who is with American Safety Razor Co., had a company which was purchased by Philip Morris. Apparently their effort was to try to build it as a competitor in the marketplace to Gillette, is that correct?

Mr. BAKER. Yes; they spent a great deal of money attempting to build that business.

Mr. BEDELL. And they were unsuccessful in those efforts, at least not as successful as they hoped they would be, and made a decision to sell the company. Bic Pen Co., which is a French-owned firm, wanted to buy it. The Federal Trade Commission refused to let them buy it even though American Safety Razor only had 10 to 14 percent of the market and Gillette had 60 percent of the market.

The Federal Trade Commission gave no consideration to what it would do to the community. I just made the point, that if you have somebody who dominates 60 percent of the market, for one with 14 percent to sell to one that has 1 percent would not seem to be detrimental to competition within that particular industry.

I guess the next question I would have, was the business profitable at the time they wished to sell it?

Mr. BAKER. It was marginally profitable, but the return would be in no way considered satisfactory for Philip Morris, and it was much too small a business to be effectively managed by a large corporation like Philip Morris.

Mr. BEDELL. You indicated the sale price was $16 million?

Mr. BAKER. Yes.

Mr. BEDELL. Roughly what were the profits at the time that was sold?

Mr. BAKER. The before-tax profits averaged over the prior 5 years, amounted to about $1.5 million.

Mr. BEDELL. So the pretax profits were around 9 percent of what the business was sold for? That makes financing fairly difficult, I would assume.

Mr. BAKER. It makes financing impossible in essence.

Mr. BEDELL. Were those Government loans at lower interest rates in order to make financing possible? How did you swing it if you have a business that looks like it will hardly be able to pay the interest on the purchase price? How were you able to raise the money for it and get the banks to loan you money?

Mr. **Baker**. Two aspects. One was, of course, the prediction and the promise that under local management dedicated to operating that one small business, that the profit potential was larger, but the key element was the Economic Development Agency made possible a low-interest-rate loan subordinate to all the other bank loans and, in effect, the banks approached it as though it were essentially equity.

Mr. **Bedell**. What was the interest on the loan?

Mr. **Baker**. Three percent.

Mr. **Bedell**. How big a loan?

Mr. **Baker**. $6 million.

Mr. **Bedell**. You have a pretty good Congressman.

Was there any consideration of what the return would have been to Philip Morris if they had liquidated the company?

Mr. **Baker**. Yes; Philip Morris had decided that in liquidation they could recover their investment in the business.

Mr. **Bedell**. Which was?

Mr. **Baker**. $17 million. The purchase price was Philip Morris' investment in the business.

Mr. **Bedell**. So they would have come out the same whether they liquidated the business or sold it to you?

Mr. **Baker**. That is correct.

Mr. **Bedell**. That problem came through yesterday. Do you know how much of that $17 million would have been a tax writeoff if they had liquidated the business?

Mr. **Baker**. If they had liquidated, I believe the tax implications would have been zero.

Mr. **Bedell**. They simply could have sold it for that much money.

Mr. **Baker**. They would have sold off the inventory and the building and netted out $17 million, which was their book value.

Mr. **Bedell**. Mr. Tauke, do you have any questions?

Mr. **Tauke**. I apologize for not arriving for the early part of your testimony.

As I understand it, Philip Morris was having difficulty making the plant go; is that correct?

Mr. **Baker**. They no longer felt that they could build the business into a viable competitor with Gillette and had really lost interest in such a small business.

Mr. **Tauke**. Was it still profitable for them?

Mr. **Baker**. Barely, not a satisfactory return on their investment.

Mr. **Tauke**. What was the return?

Mr. **Baker**. We are talking, in effect, of an equivalent, after taxes, of approximately $750,000 on an investment of $17 million.

Mr. **Tauke**. What is your return now on the business?

Mr. **Baker**. Many times higher. We are of course a private company, and we zealously guard that number, but several times higher.

Mr. **Tauke**. Why is it that you can make it go when Philip Morris could not?

Mr. **Baker**. We manage the business with far fewer management people. We can make decisions—with a meeting in 1 hour we can decide something that would take months to go through the hierarchy of a large corporation.

Because those who invested in it are managers of the company, and they have everything invested in it, they have a high degree of motivation to make it go and the failure would be a very personal thing and we have opted not to try to displace Gillette as the No. 1 company in the marketplace.

They have a 60-percent share. Their position is such that it would be foolhardy for us to attempt to try to take over the No. 1 spot as Philip Morris would have liked to have done.

So we content ourselves with dealing with those sectors of the market that Gillette is not currently operating in. We developed a women's shaving market, because Gillette paid very little attention to women's shaving. We have recently introduced a shaving device for black men because they have special shaving problems, and Gillette has chosen to ignore that whole segment of the market.

We believe we can operate effectively in those sectors and are content to operate profitably in those sectors.

Mr. **Tauke**. So it isn't that Philip Morris didn't try? It is simply that perhaps they weren't as able or as competent in terms of management?

Mr. **Baker**. It is hard to make that kind of statement about as successful a company as Philip Morris, but in the small business—our business didn't get the attention it would have needed.

Mr. **Tauke**. Perhaps they didn't understand the business?

Mr. **Baker**. I am sure that is very much a part of it. They didn't understand the business and didn't have time to learn it.

Mr. **Tauke**. When you decided to purchase the business from Philip Morris, was there any difficulty in dealing with the company, with Philip Morris, in this effort? Was their decision based solely, do you believe, on economic profit and loss statements, or was it a decision that was based in part on the desire to maintain the company in your community?

Mr. **Baker**. Because I was an employee of Philip Morris, I naturally had to obtain permission to try to put this deal together, which I did. They were rather reluctant to let me go ahead. I think with good reason they were afraid that the company would fail. I would think natural pride might make them think no one could do better than they could.

If the company had failed, I think that with good reason they were afraid that they would be accused of dumping the business off on its poor unsuspecting employees.

So with a certain amount of rather severe reluctance, they permitted me to go ahead. They would have preferred to liquidate the business and try in some other way to affect the employment problem.

Mr. **Tauke**. You apparently were able to convince them you could make a go of it?

Mr. **Baker**. Yes.

Mr. **Tauke**. Well, I want to congratulate you and also say I agree with my chairman that you do have a fine Member of Congress. This is my first term in Congress and I have appreciated his counsel and advice, not that I always follow it, of course, but it certainly is appreciated.

Thank you very much.

Mr. Bedell. Mr. Baker, when it came before the FTC, apparently Philip Morris signed an affidavit. [See Appendix G.] I am advised by staff, that the affidavit said if the sale was not permitted they would close the business. Is that accurate or not?

Mr. Baker. Yes; that is correct.

Mr. Bedell. So the FTC did have that information, right before them?

Mr. Baker. Yes, absolutely, and intimated that Philip Morris was bluffing.

Mr. Tauke. Mr. Chairman, if you will yield for one moment, did the FTC give specific reasons for turning it down? Perhaps you have gone over this.

Mr. Baker. Yes; it was primarily on the No. 5 company acquiring the No. 3 company in the same business, a book rule.

Mr. Tauke. Thank you.

Mr. Bedell. We appreciate very much your being here.

Congressman Butler, do you have anything to add?

Mr. Butler. I might throw in that since I was pretty intimately involved in this from time to time, I just think that we ought to recognize how difficult it was to get the attention of the Commission itself while these judgments were being made at the staff level——

Mr. Bedell. The Federal Trade Commission?

Mr. Butler. Yes, the Federal Trade Commission. The problem was that even after it had withdrawn the transaction, it was still in an adjudicative status and that meant the Federal Trade Commission wouldn't talk to anybody, or wouldn't talk to me from the legislative branch at all until actually the procedural details of dismissing the complaint that was pending in the Federal district court in New York, I believe—that procedural nicety had been cleared up, and while they were trying to go back and find out on what basis the Bic transaction could be made acceptable to the Federal Trade Commission.

The bureaucracy of it all and the inability to get the Federal Trade Commission, during this period when Bic was trying to decide maybe there is some other way we can get it together, whether Philip Morris was going to liquidate or sell it to the employees, all during that period, just the difficulty of getting the attention of the Federal Trade Commission itself, I think, is a factor that we ought not to have to live with in situations of this nature.

I would hope that the committee would take some look at that.

Mr. Bedell. Was there any indication that Gillette had any hand in the Federal Trade Commission decision?

Mr. Butler. Had any what?

Mr. Bedell. Had any influence in the Federal Trade Commission decision?

Mr. Butler. I can't respond to that.

Mr. Baker. It is widely thought in the industry that they were the instigator of it.

Mr. Bedell. Of the——

Mr. Baker. Of the Federal Trade Commission action.

Mr. **Bedell**. I assume there would be nothing improper in them trying to preserve their position.

Mr. **Baker**. I am not suggesting that.

Mr. **Bedell**. I think maybe I am. Was there any indication of any impropriety in the way they pursued with the Federal Trade Commission a decision which at least on the face of it looks pretty strange to me?

Mr. **Baker**. I have no evidence that there were any improprieties.

Mr. **Bedell**. Nor it has not been rumored in the industry that that was the case?

Mr. **Baker**. No.

Mr. **Bedell**. You have no further questions, Mr. Tauke?

If not, we want to thank you very much, for being here; and thank you for your help.

PANEL CONSISTING OF WITNESSES FROM YOUNGSTOWN, OHIO: ED KELLY, JOHN GREENMAN, REV. CHARLES RAWLINGS, AND STAUGHTON LYND

Mr. **Bedell**. Our next panel consists of individuals from Ohio in regard to the Youngstown situation

Gentlemen, would you please stand, raise your right hand and be sworn in?

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Reverend **Rawlings**. I do.

Mr. **Kelly**. I do.

Mr. **Greenman**. I do.

Mr. **Lynd**. I do.

Mr. **Bedell**. First, Senator Metzenbaum had expected to be here to testify. He had to be in Ohio, but I understand he has requested that he be permitted to offer a statement for the record and without objection, we will enter his statement in the record.

[Senator Metzenbaum's prepared statement follows:]

Prepared Statement of Senator Howard M. Metzenbaum

Mr. Chairman, I appreciate your giving me this opportunity to testify before your Subcommittee on a matter of such critical importance. At the outset, I want to commend you for your ambitious undertaking in these hearings.

As you know, investigations into the conglomerate merger phenomenon—by Congress, the Administration, concerned interest groups—have been taking place for some time. The ills of conglomerate mergers are many and the benefits speculative at best.

But no aspect of the problem could be more significant than the one you are currently investigating—the impact of such mergers on local communities. No result of conglomerate mergers is more painful to see than the withering of local entrepreneurship and the strains on the very fabric of a community which result from plant closings and massive unemployment.

You have before you today—in the experience of Youngstown, Ohio—a most graphic example of the devastation which conglomerate mergers can bring down upon a community. The witnesses you will hear from today are intimately familiar with the trauma faced by the city of Youngstown as a result of the acquisition of locally owned and managed Youngstown Sheet and Tube Company by Lykes Corporation, a relatively small, New Orleans-based shipping firm. As a result of the merger, we saw a healthy firm in the steel-making business systematically milked by absentee owners, less interested in the steel business and the Youngstown community than they were in using the company's annual cash flow of $100 million for their own purposes.

Ultimately, this process led to the closing of major plants in Youngstown and the loss of thousands of jobs:

(1) In 1977 Lykes shut down Youngstown Sheet and Tube's Campbell Works, resulting directly in the layoff of 5,000 workers and indirectly in the loss of another estimated 6,000-10,000 jobs.

(2) Two months' ago, Jones and Laughlin which acquired Sheet and Tube when its parent, LTV, merged with Lykes, announced the shutdown of Sheet and Tube's Brier Hill Works employing another 1,400 workers.

Founded in 1900, Youngstown Sheet and Tube grew into an immensely successful local business. During the 1920's it acquired the Brier Hill Steel Company—also a local Youngstown business—and purchased interests in coal and iron ore mines. Local management and local employees built Sheet and Tube into a very successful steel-making business. Capital was continually plowed back into the company's Youngstown facilities to keep the business and the community thriving. Its current workers—those that are left—are second and third generation Sheet and Tube employees.

Prior to its acquisition by Lykes in 1969, Youngstown Sheet and Tube was the eighth largest steel company in the nation, and the largest single employer in the Mahoning Valley. The company was thriving and had a cash flow sufficient to maintain and modernize its facilities or to service debt incurred for that purpose. It used its iron ore and coal interests wisely—and profitably—as part of its steel-making operations.

Sheet and Tube's fall begin when it was purchased by Lykes a company one third its size. (At the time of the purchase Lykes had $376 million in assets, while Youngstown Sheet and Tube had $1.026 billion in assets.) According to testimony heard by the Senate Antitrust Subcommittee about a year ago, Youngstown Sheet and Tube was subsequently milked by the Lykes conglomerate to its own advantage. How was this accomplished? Testimony at our hearings revealed the following:

Youngstown Sheet and Tube was forced to buy parts and equipment from Lykes subsidiaries at prices higher than those charged by local concerns, thereby improving the subsidiaries' margins at the expense of Sheet and Tube.

Lykes forced financial arrangements on Sheet and Tube which resulted in the steel company paying more for the iron ore and coal it purchased from Lykes' own mines than its competitors had to pay for the materials they used.

Sheet and Tube's facilities were not adequately maintained—workers frequently were unable to obtain necessary spare parts.

Sheet and Tube's share of the domestic steel market fell from 4.6 per cent in 1965 to 3.6 per cent in 1975, two years before the Campbell Works in Youngstown were shut down.

Lykes used Sheet and Tube's cash flow to service the debt it had incurred in acquiring Sheet and Tube in the first place and to make other acquisitions as well. For example, in 1969 Lykes acquired the Coastal Plains Life Insurance Company; in 1971 it purchased half of the South American Steamship Company owned by W. R. Grace; in 1973 it purchased Ramseyer and Miller, Inc.; and in 1975 it acquired the Great Western Steel Company. As a result Lykes did not have the capital to maintain and modernise the Sheet and Tube facilities. Sheet and Tube's inability to take advantage of the 1973-74 boom period in steel, the closing of Youngstown's Campbell Works in 1977 putting 5,000 people out of work, and the recently announced closing of the Brier Hill Works are all directly attributable to Lykes' failure to modernize Sheet and Tube's facilities.

Massive unemployment, severe drains on city social services, and a depleted municipal tax base are the all too familiar prices Youngstown had to pay for conglomerate growth. And on a larger scale, the shutdowns have taken their toll on the steelmaking industry as a whole, reducing a formerly strong competitor to a shell of its former self, much less able to exert a needed competitive influence in the marketplace.

What happened in Youngstown was not surprising. Lykes did not know the steel business, nor was it committed to that business. In short, it had no concern for the goals that local management had pursued. Without such ties to the community or the commitment to local management's goals, the absentee owners set in motion a series of events that were almost inevitable. The shutdown of local operations with the attendant toll in human misery that the community and people of Youngstown are still paying was predictable. In fact, prior to the merger, that result was predicted by the Justice Department which unfortunately took no steps to prevent what the Department itself knew to be a disastrous merger.

Mr. Chairman, the time has come to put a stop to such corporate marauding. If the disastrous outcome of conglomerate mergers is predictable and the enforcement authorities are unwilling or unable to head off the dire results, then Congress must act.

Unfortunately, our current antitrust laws may not be up to the task. While Section 7 of the Clayton Act is effective against horizontal mergers—mergers between direct competitors—it may not be sufficiently broad to reach the growing phenomenon of conglomerate mergers. Both the Federal Trade Commission and the Justice Department have met with little success in challenging such mergers under competitive reciprocity. Although the courts have accepted such doctrines in principle the difficulties of proof demanded are frequently overwhelming.

That is why the Senate Antitrust Subcommittee is considering legislation that would preclude mergers such as the Lykes-Youngstown acquisition, unless it could be demonstrated that such mergers would generate positive results, either an increase in competition or the generation of efficiencies. (I would like to insert in the record if I may a copy of that legislation—S. 600—for your Committee to consider.)

Had there been such legislation at the time Lykes proposed its acquisition, it is doubtful the acquisition would have been permitted. Youngstown might have averted many of the horrors it has suffered over the last decade. Mr. Chairman, this nation cannot tolerate any more Youngstowns. We must pass meaningful legislation—and soon. Thank you.

Mr. **Bedell**. Would you introduce yourself so we know who is here? Then you may proceed.

Reverend **Rawlings**. I am the Reverend Charles Rawlings, I am the officer for Church and Society in the Episcopal diocese of Ohio, and a member of the Ecumenical Coalition of Youngstown.

The other three persons to provide testimony on the merger situation which affected Youngstown, are the general counsel of the Ecumenical Coalition, Staughton Lynd, seated to my far left; Ed Kelly, the research director of the Ohio Public Interest Campaign; and John Greenman, urban affairs editor of the Warren Tribune Chronicle.

The logical sequence we suggest to you is that you hear first from Mr. Kelly, then from attorney Lynd, and Mr. Greenman, and my testimony would come at the end of that.

Mr. **Bedell**. You may proceed, Mr. Kelly. I should tell you, you can either read your statement or any time you want to summarize we will enter the full statement in the record.

TESTIMONY OF ED KELLY, RESEARCH DIRECTOR, OHIO PUBLIC INTEREST CAMPAIGN

Mr. **Kelly**. I am the research director of the Ohio Public Interest Campaign, a statewide nonprofit citizens organization which is especially concerned with questions of jobs and maintaining a tax base throughout the State of Ohio.

I am here today to talk about the situation of the Lykes Corp. and Youngstown Sheet and Tube which closed in 1977.

Shortly after the announced closing of the steel mill in Youngstown, which involved about 5,000 jobs, I began an investigation looking into the question of why the closing took place. I want to speak about what I found in that investigation.

I found a number of things. First, I found that Lykes Corp., which was a New Orleans-based shipping company, took over Youngstown Sheet and Tube in 1969 in order to attempt to become a conglomerate corporation.

Lykes saw Sheet and Tube as a tremendous source of cash due to the large depreciation charges which, together with profits, gave Youngstown a very large cash flow of about $100 million annually. This was not a unique situation in the steel industry during the sixties. Many conglomerates saw the steel industry as a prime target for their growing expansion and takeover plans. Business Week later described the situation as follows: "The conglomerateurs' steel acquisitions were seen as cashboxes for corporate growth in other areas."

I found that Lykes was much smaller than Sheet and Tube, so that a very large debt load had to be taken on by Lykes in order to take over Sheet and Tube. Lykes in 1969 when the merger took place, had $137 million in assets, whereas Sheet and Tube's assets were $806 million.

So in order to facilitate the takeover, Lykes, in addition to issuing a large issue of preferred stock, also issued $191 million in debentures, and borrowed about $175 million from a number of large banks, including Chemical, Chase Manhattan, City, Marine Midland, and Philadelphia National Bank.

Between the debentures and the bank loans, this created an extremely risky burden of debt for that company—especially in an industry as cyclical as the steel industry.

When the early seventies proved to be bad years for the steel industry, Lykes was forced to use virtually all the cash flow generated by Sheet and Tube to service the debt, both the interest and paying off some of the principal. During that period they paid over $40 million per year in interest payments alone on the debt they had acquired, and left nothing for modernization of steel mills and they were in a situation where they were forced to avoid routine maintenance on the steel mills.

Lykes' bankers, which had really been vital to the takeover in the first place—they never could have taken over Sheet and Tube without them—began to reduce the credit availability to Lykes during the seventies, and at the same time began to greatly increase their loans to Japanese steel companies.

The seventies were a period when foreign banks, American and other banks began to make tremendous loans to Japanese industry, and the largest industry they made loans to was the steel industry. About 11 percent of the debt of the Japanese steel industry is now owed to American and other foreign banks.

Three of the prime banks, Citibank, Chase Manhattan, and Bank of America, were among the leading American banks that were making loans to Japanese steel at the time. Chemical Bank and some other banks were also making major loans, so you had a situation in which while the steel industry was talking about imports hurting them, you had the very bankers of the steel industry lending money to the Japanese steel industries to import back into this country.

I found that because of the neglect of the steel side of their business, in the early 1970's, that the Sheet and Tube facilities in Youngstown declined in terms of machinery, which began to break down, and more and more capacity had to be out of production at any given time. And when 1973–74 turned out to be good years for the steel industry, Lykes was unable to take full advantage of the boom period, and the nature of the steel industry is such that you have to make a lot of money on the last few percentages of capacity because that is when you have all your fixed costs taken care of, and Lykes was forced to farm out a lot of those extra orders because they had let their equipment run down in the early 1970's;

they couldn't run their plants flat out and were forced to farm out orders.

So they were not able to make the kind of profits in the middle 1970's that they should have if they had taken care of their equipment.

Now, the failure to take full advantage of this 1973-74 boom period really doomed the modernization plans that were in place for the Campbell Works in Youngstown. Because of the nature of the steel business, you have to make a lot of money in the good years to tide you over for the bad years that are almost inevitable to happen, and capital expansion plans which take place over a long period of time must go through both good years and bad years, and you must build up enough capital in the good years to carry you through the bad years and continue your modernization plans.

They failed to make enough money in 1973-74 because of the previous failure in the early 1970's to take care of their equipment and modernize, so they were not able to carry through modernization plans in the late 1960's. And so they got into a position in the late 1970's when even though they hoped to put in new furnaces in Campbell and do other kinds of modernization, they were finally forced to say they could not do that, and they finally blamed the closing that took place in 1977 partly on imports, environmental regulations, and lack of profitability, but also they said they could not afford to spend the money necessary to make Campbell profitable.

I think that the claims they made about imports, environmental regulations, et cetera, have some validity, but the fact that they did not have the money to modernize was in many ways the prime factor, and that was their own doing in many ways, because of the previous things that happened in the seventies.

I think the important thing here is that Sheet and Tube, before it was taken over by Lykes, had done quite a bit of modernization in their other facilities in Chicago, and had online plans to do a lot of modernization of the Youngstown facilities during the seventies. Between 1966 and 1968, for example, they spent $364 million in capital expenditures. Those were the 3 years prior to the merger. Those were primarily on the Chicago operations.

After the merger, between 1970 and 1973, they averaged only $27 million per year in capital expenditures, so you can see the tremendous falloff that took place after the merger, and it is my feeling that if the merger had not taken place and Sheet and Tube had been allowed to remain an independent company that those modernization plans that were on the books would have taken place, that the cash flow of the steel company which rose primarily from the depreciation of the steel would have been used to modernize steel instead of financing the interest and debt payment of the conglomerate, and I think we would have seen a different situation in Youngstown today, and I don't think we would have had the closings.

There is one unfortunate aspect that I would like to briefly get into, and that is in 1969 the Justice Department investigated the proposed merger of Lykes and Sheet and Tube. George Schueller, the Assistant Chief of the Trial Section of the Justice Department, recommended the merger be opposed by the Justice Department.

What I am saying now comes from information we obtained through the Freedom of Information Act. Through this act we had access to the internal documents of the Justice Department on this matter. [See Appendix H.]

The prime reason why Schueller recommended that they oppose the merger was not that it was going to create a larger company on a traditional sort of antitrust ground, but rather that the merger would affect the viability of the company within the steel industry.

The report said that the merger jeopardizes Youngstown's competitive viability in terms of finances required for technological improvements and innovations in its steel production facilities.

The report points out that the $100 million annual cash flow of Youngstown was being used for expansion and predicted that in the future. This level needed to be maintained, but it would not likely take place.

It says that the modernization plan appears to be put in jeopardy by the merger with Lykes, and it also predicts that Lykes, even though it was much smaller than the Youngstown components, would be the dominant factor in the postmerger company. It said it cannot seriously be doubted that Youngstown is slated to become an appendage of Lykes, even though this is a case of the tail wagging the dog and a steelmaking interest will not be paramount in the new company's conduct.

Unfortunately, despite the predictions of the Justice Department's Antitrust Division, which we found to be all too accurate, the initial studies we did prior to receiving the Justice Department information, and we were amazed to find our analysis, after the fact, really correspond almost completely with what the Justice Department predicted prior to the merger, and yet someone—we don't know who—decided to overrule the Antitrust Division and not oppose the merger, and it was allowed to take place, and all the things they predicted did take place with terrible consequences.

So that is all I have in the way of a prepared statement. If you have any questions, I would be glad to answer them.

Mr. **Bedell**. I do have several questions, and I am sure others will have as well. I think we will probably proceed through the panel and then come back.

[Mr. Kelly's prepared statement follows:]

PREPARED STATEMENT OF EDWARD KELLY, RESEARCH DIRECTOR, OHIO PUBLIC INTEREST CAMPAIGN

My name is Edward Kelly. I am the research director of the Ohio Public Interest Campaign, a non-profit statewide citizens organization which is concerned about the loss of industry, jobs and the tax base in Ohio.

I am here today to share with you information about the closing of a major steel mill in the Youngstown, Ohio area in 1977. That mill, which employed 5,000 people, was the Campbell Works of Youngstown Sheet and Tube Corporation, a subsidiary of Lykes Corporation.

In 1977, shortly after Lykes announced the closing, I began an investigation of the developments which led to the closing. I discovered the following:

(1) *Lykes acquired Youngstown Sheet and Tube in 1969. In doing so, Lykes hoped to become a diversified conglomerate.*—Lykes, a New Orleans based shipping company saw Sheet and Tube as a tremendous source of cash due to large depreciation charges which, together with profits, gave Youngstown a cash flow of about $100 million annually. This was not a unique situation. During the 1960's the steel industry became a prime target of the growing number of conglomerate corporations seeking to expand. As Business Week later said: "The conglomerateurs' steel acquisitions were seen as cash boxes for corporate growth in other areas." (10/3/77)

(2) *Lykes was much smaller than Sheet and Tube. So a very large debt load was taken on to finance the acquisition.*—In 1969 Lykes had assets of $137 million compared with Sheet and Tube's $806 million. In the acquisition Lykes issued preferred stock to Sheet and Tube stockholders but Lykes also issued $191 million in debentures and borrowed about $175 million from a number of banks including Chemical Bank, Chase Manhattan, Citibank, Marine Midland, and the Philadelphia National Bank.

Between the debentures and the bank loans, this was an extremely risky burden of debt, especially for a company in as cyclical an industry as steel.

(3) *When the early 1970's were bad years for steel, Lykes used virtually all of Sheet and Tube's cash flow for debt payments.*—Over $40 million per year went to interest payments alone. Other cash went toward retiring debt. So nothing was left for steel modernization or even routine maintenance.

(4) *Lykes' bankers, which had made the takeover of Sheet and Tube possible—and so were partially responsible for the outcome—reduced credit to Lykes. At the same time they greatly increased credit to Japanese steel companies—the source of much of the foreign imports which are competing with American steel companies.*—During the 1970's foreign banks expanded their loans to Japanese industry tremendously. The largest increase was to the steel industry which now owes about 11 percent of its total debt to foreign banks. American banks have been in the lead in this increase. Of American banks, three have been primary: Citibank, Chase Manhattan, and the Bank of America. The first two were among the major deserters of Lykes in the same period. Chemical Bank and other Lykes' bankers also increased their Japanese steel loans then too.

(5) *Because of Lykes' neglect, Sheet and Tube was unable to fully benefit from the steel boom period of 1973-4.*—Demand for steel was high in 1973-4 but Sheet and Tube's equipment kept breaking, so many orders had to be farmed out to other companies. This meant a great loss of potential profits.

(6) *The failure to take full advantage of the 1973-4 period doomed steel modernization plans.*—Because of the cyclical nature of the steel industry, it is vital that companies do extremely well during boom years to carry them through bad years. Capital that is saved during the boom years can be used to modernize over longer periods—even during bad years. Lykes' failure to fully benefit from 1973-4, caused by their actions in 1969-72, led to the 1975-7 period, when steel modernization failed to happen.

In June, 1974, Lykes announced plans for a basic oxygen steelmaking facility at the Campbell Works. This modernization would have greatly increased Campbell's competitiveness and would have virtually assured continued production there. Unfortunately, due to lack of cash or credit, the modernization never took place.

(7) *The closing, when it took place in 1977, was blamed on imports, environmental regulations, and lack of profitability. Lykes said it could not afford to spend the money necessary to make Campbell profitable.*—There is some truth to these claims although there is some evidence that the mill was still marginally profitable. But behind these claims is a much more important fact: Lykes own actions, beginning with the reckless takeover of Sheet and Tube in 1969, were really the cause of the problems of profitability and lack of modernization.

(8) *If Lykes had not acquired Sheet and Tube, most likely the Campbell Works would be operating today.*—Beforehand Sheet and Tube had modernized its operations near Chicago and was planning to modernize in Youngstown. Capital expenditures between 1966 and 1968 were $364 million. They almost totally stopped after the merger averaging only $27 million per year between 1970 and 1973.

If Sheet and Tube had remained independent, there is every reason to believe that its large cash flow would have been used to modernize Campbell and other Youngstown facilities. If Lykes had not gambled with the futures of thousands of Youngstown employees, taxpayers, and small businesses, the picture in Youngstown today would most certainly be a lot brighter.

Reverend RAWLINGS. Mr. Chairman, Mr. Lynd is the next person, and his testimony, in effect, is stage two of the story of merger in Youngstown.

TESTIMONY OF STAUGHTON LYND, GENERAL COUNSEL, ECUMENICAL COALITION OF THE MAHONING VALLEY COUNCIL, TRI-STATE CONFERENCE ON THE IMPACT OF STEEL

Mr. LYND. Mr. Chairman, the Youngstown Sheet & Tube Company had two mills in Youngstown. It had the Campbell Works on the south side of town, which, as Mr. Kelly has just described, was largely closed in September 1977. On the north side of Youngstown, Sheet & Tube had the so-called Brier Hill Works, which closed only the end of last year, in the last week of December 1979.

This second closing, of the Brier Hill Works, was the indirect result of the merger between Lykes and Youngstown Sheet & Tube in 1969 and the direct result of a second merger between the Lykes conglomerate, on the one hand, and the Ling-Temco-Vought, or LTV, conglomerate owner of Jones & Laughlin Steel, on the other hand, which was approved by the Justice Department in June 1978.

So the story that I and Mr. Greenman will unfold is the story of this second merger and this second mill shutdown.

The Brier Hill Works is located on the north side of Youngstown, east of the Mahoning River. Before it was shut down in December 1979, it employed about 1,200 hourly employees. Its product was a component of seamless pipe, known as rounds, which were made in open-hearth furnaces of the Brier Hill Works and finished off in the blooming mill, and those rounds made in Sheet & Tube's Brier Hill Works were then sent to the south side of Youngstown to the Campbell Works where Sheet & Tube still maintained a portion of its old facilities which made seamless pipe.

That was the situation as of 1977 and 1978.

Then, in November 1977, the Lykes conglomerate announced a proposed merger with the LTV conglomerate. And on February 3, 1978, LTV's chairman and chief executive officer came to Youngstown, met with community leaders but not with the representatives of workers at Brier Hill and announced that if the Lykes-LTV merger were consummated, the Brier Hill Works might be shut down.

The reason was obvious. Jones & Laughlin, the steel subsidiary of LTV, had a steel mill at Aliquippa, Pa., about 60 miles from Youngstown, which made the same product that Brier Hill made, rounds for seamless pipe.

The Aliquippa facilities were more modern than those at Brier Hill and had unused capacity. Brier Hill steelworkers were among the first to observe that the mere fact of this merger, the bringing together of the two companies, might cause LTV to shut down Brier Hill and supply the Campbell pipe mill with rounds from Aliquippa.

Both the United Steelworkers of America and the Ecumenical Coalition of the Mahoning Valley sought to persuade the Justice Department, if a merger between Lykes and LTV were permitted, that conditions should be attached which would protect the workers at Brier Hill.

It seemed contrary to the intent and the letter of the antitrust laws to permit a merger which not only decreased competition, but cost jobs.

The merger was justified by its corporate sponsors as necessary because Lykes was a failing company, but we asked, was the company to be restored to health only at the expense of its workers' jobs?

In a brief submitted by the Ecumenical Coalition to the Justice Department in April 1978, we argued that the antitrust laws, the Sherman Act and the Clayton Act were intended to protect not only businessmen, but also workers. And we cited the congressional debates at the time those laws were enacted in support of our proposition.

Specifically, the Coalition, together with the United Steelworkers of America, asked the Justice Department, should it determine that the merger was otherwise acceptable, to attach the following conditions to the merger to prevent job loss:

One, the merged corporation should commit itself not to permanently close any substantial producing units of any of its plants, including Brier Hill, without first obtaining permission from the Justice Department.

Two, the Justice Department should make it clear that permission for such closure of a substantial producing unit would only be given upon a showing by the merged corporation that (a) severe losses are experienced if the facility were not closed, and (b) there is no way to obtain funds for modernization of the facility, including community or Government loans or loans guaranteed by the Government.

We sought, in other words, to bring about a situation where a corporation which the Government had permitted to merge would be required to come before the Government and show just cause for the further shutdown of any major facility.

On June 20, 1978, then Attorney General Griffin Bell overruled his own Antitrust Division and, as Attorney General Mitchell before him had approved the merger of Lykes and Youngstown Sheet & Tube, Attorney General Bell approved the merger of Lykes and LTV without conditions.

In the meantime, local 1462 of the United Steel Workers of America, the bargaining representative for the hourly employees at Brier Hill, repeatedly sought to meet with the corporate executives about the fate of the mill.

On June 30, 1978, Ed Mann, local union president, and Gerald Dickey, recording secretary, wrote to Thomas Graham, president and chief executive officer of J. & L. "We feel it is time for us to meet face to face and discuss the future of Brier Hill," they wrote. "Our membership is going under a severe strain facing the realities that lie ahead."

On July 10, 1978, Mann received a letter from J. H. Kirkwood, vice president of J. & L., which told the union representatives:

> Our policy here at J. & L. has always been to meet with the bargaining unit representatives of our employees on matters of importance and mutual interest, and you may be assured that that policy will be continued subsequent to the merger.

In other words, although in these premerger months executives of Sheet & Tube and J. & L. were meeting constantly to plan their future course as a company, J. & L. refused to meet with its employees-to-be until after the merger.

As a result, Lykes and LTV stockholders learned of the planned closing of the Brier Hill works before the workers there. On October 27, 1978 Lykes and LTV issued a joint prospectus which forecast a phasing out of Youngstown iron and steelmaking and round-producing operations, which meant Brier Hill in the Mahoning Valley during the latter part of 1979.

Desperate, on November 20, 1978, local union representatives again addressed J. & L. management. Citing a Wall Street Journal account of the prospectus, they urgently renewed their request for a meeting.

Only on December 14, 1978, 10 days after consummation of the merger, were Mann and his colleagues finally told their mill would definitely be closed. Not until January 19, 1979, did J. & L. management sit down with local 1462 representatives to discuss whether anything could be done to save Brier Hill.

As if in symbolic recapitulation of all that had gone before, Mayor Philip Richley of Youngstown, two representatives of Congressman Lyle Williams and an aide to Senator Edward Kennedy, all of whom had been invited to attend that meeting by the union, were excluded from the meeting by J. & L.

In December 1979, as I said at the outset, the shutdown of the Brier Hill Works finally came to pass and steelmaking ceased at that mill.

[Mr. Lynd's prepared statement follows:]

PREPARED STATEMENT OF STAUGHTON LYND, GENERAL COUNSEL, ECUMENICAL COALITION OF THE MAHONING VALLEY COUNCIL, TRI-STATE CONFERENCE ON THE IMPACT OF STEEL

Almost from its inception, the Ecumenical Coalition of the Mahoning Valley was concerned with the fate of Youngstown Sheet and Tube's Brier Hill Works. The Coalition saw its task, not only as attempting to create jobs at the Campbell Works, but also as attempting to retain jobs at the Brier Hill Works. There was a fear that the decisionmakers who had terminated more than 4,000 jobs at the Campbell Works on two hours' notice might be equally ruthless in dealing with their workers at the Brier Hill Works.

The Brier Hill Works is located north of the city of Youngstown, and east of the Mahoning River. Before it was shut down in December 1979 it employed about 1,200 hourly employees. Its principal product was "rounds," a component for seamless pipe which after its manufacture at the Brier Hill Works was sent to the Campbell Works for finishing. Steelmaking at the Brier Hill Works was by open hearth, but installation of oxygen lances had increased productivity by more than 40 per cent.[1]

On November 8, 1977, less than two months after "Black Monday," the Lykes corporation, conglomerate parent of Youngstown Sheet & Tube, announced a proposed merger with the LTV corporation, conglomerate parent of Jones & Laughlin Steel. On February 3, 1978, Paul Thayer, LTV chairman and chief executive officer, came to Youngstown, met with community leaders (but not with the representatives of workers at Brier Hill), and announced that if the merger was consummated the Brier Hill Works might be shut down.[2]

The reason was obvious. Jones & Laughlin had a steel mill at Aliquippa, Pa. which made the same product that Brier Hill made, "rounds" for seamless pipe. The Aliquippa facilities were more modern than those at Brier Hill. Brier Hill steelworkers were among the first to observe that the mere fact of merger—of bringing two plants under separate ownership into the same conglomerate—might cause LTV to shut down Brier Hill and supply the Campbell pipe mill with "rounds" from Aliquippa.

Both steelworkers and the Ecumenical Coalition sought to persuade the Justice Department that if a merger between Lykes and LTV were permitted, conditions should be attached which would protect the workers at Brier Hill. It seemed contrary to the intent and letter of the anti-trust laws to permit a merger which not only decreased competition, but cost jobs. The merger was justified by its corporate sponsors as necessary because Lykes was a "failing company." But was the company to be restored to health only at the expense of its workers' jobs? In a brief to the Justice Department, submitted on April 18, 1978, the Coalition's attorneys quoted from the Congressional debates at the time the Clayton Act was enacted. Monopoly, Congressman Barkley stated, "has sometimes resulted in the closing of manufacturing plants and the throwing out of employment of men."[3] Congressman Austin declared that the Act was presented as "a remedy for the closing of the mills."[4] Warned Congessman Metz:

---

[1] Editorial, "The Costs of Merger," Youngstown Vindicator, Nov. 1, 1978.

[2] "Merger Would Cut More Jobs," Youngstown Vindicator, Feb. 7, 1977.

[3] 51 Cong. Rec. 9553 (1914).

"In a small mill town you and I know what stopping means. The mill town is entirely helpless without the mill. It depends on the mill running."[5]

The Coalition brief rejected the legal argument that the anti-trust laws are intended only to protect businessmen, not workers. The Coalition asserted that it sought to redress injuries which Congress enacted the Sherman and Clayton Acts to prevent.

Accordingly, the Coalition joined the United Steelworkers of America in insisting that, should the merger of Lykes and LTV be approved, the following conditions should be attached:[6]

(1) The merged corporation should be required to reopen Campbell Works (including the Struthers plant), or cooperate fully with any reasonable proposal which may be developed for Campbell Works to resume operations under another business structure. The merged corporation should not be permitted to cannibalize the equipment of Campbell Works, nor sell it to liquidators, and it should be required to provide minimum necessary maintenance and mothballing of such equipment for at least a two year period.

(2) The Justice Department should retain power to investigate any charges of refusal of cooperation with a prospective buyer or operator of Campbell Works, and to issue a ruling specifying actions to be taken to resume steel production at Campbell on the soundest possible basis, as quickly as possible.

(3) The merged corporation should commit itself not to permanently close any substantial producing unit of any of its plants (including Brier Hill, the Seamless Tube Mill at Aliquippa, the Tin Mill at Aliquippa, sheet mills in Pittsburgh, etc.) without first obtaining permission from the Justice Department.

(4) The Justice Department should make it clear that permission for such closure of a substantial producing unit will only be given upon a showing by the merged corporation that

(a) Severe losses would be experienced if the facility were not closed, and

(b) There is no way to obtain funds for modernization of the facility (including community or government loans or loans guaranteed by the government).

(5) The Justice Department should not permit the merged company's debts to be increased because of the merger. In other words, the merger should be permitted if, and only if, the Lykes' stockholders are willing to accept common stock (rather than preferred stock, bonds, or notes) for their present shares in Lykes. By this action, the Justice Department will serve notice that it will no longer approve the practice of draining a steel company's earnings to pay for its acquisition by another company. To compete, and possibly to survive, the merged company must modernize its facilities. It cannot carry additional debts.

On June 20, 1978, then Attorney General Griffin Bell overruled his own Antitrust Division, and approved the merger of Lykes and LTV without conditions. By means of a suit brought under the Freedom of Information Act, the Ecumenical Coalition and the Brier Hill Works local union obtained much of the documentation underlying this decision. Reporter John Greenman of the Warren Tribune Chronicle supplemented the documents by interviewing the dramatis personnae from Bell down, and has told the story in a brilliant series which began in the issue of December 9, 1979.

Meantime Local 1462, United Steelworkers of America, repeatedly sought to meet with the Lykes and LTV decisionmakers, concerning the fate of the Brier Hill Works.[7] On June 30, 1978, Ed Mann, local union president, and Gerald Dickey, recording secretary, wrote to Thomas Graham, president and chief executive officer of J & L. "We feel it is time for us to meet face to face and discuss the future of Brier Hill," they wrote. "Our membership is undergoing a severe strain facing the uncertainties that lie ahead." On July 10, 1978, Mann received a letter from J. H. Kirkwood, Vice President—Industrial Relations for J & L: "Our policy here at J & L has always been meet with the bargaining unit representatives of our employees on matters of importance and mutual interest and you may be assured that that policy will be continued subsequent to the merger." In other words, although in those premerger months executives of Sheet & Tube and J & L were meeting constantly to plan their future course as a company, J & L refused to meet with its employees-to-be until after the merger.

---

[4] 51 Cong. Rec. 9484 (1914).

[5] 51 Cong. Rec. 9263 (1914). Additional citations are presented in Thomas R. Asher, Paul Alan Levy, and Staughton Lynd, "Memorandum to the United States Department of Justice Regarding the Proposed Merger of the Lykes Corporation and the LTV Corporation," submitted by the Ecumenical Coalition of the Mahoning Valley, Apr. 18, 1978, pages 17–19.

[6] Appendix to Edward F. Kelly, "Lykes and its Bankers," prepared by the Ohio Public Interest Campaign, 340 Chester-12th Building, Cleveland, Ohio 44114, Apr. 13, 1978.

[7] This correspondence is in the possession of Staughton Lynd, 804 Metropolitan Tower, Youngstown, Ohio 44503.

As a result, Lykes and LTV stockholders learned of the planned closing of the Brier Hill Works before the workers there. On October 27, 1978, Lykes and LTV issued a joint prospectus which forecast "a phasing-out of Youngstown's iron and steelmaking and round-producing operations in the Mahoning Valley during the latter part of 1979."[8] Desperate, on November 20, 1978 local union representatives again addressed J & L management. Citing a Wall Street Journal account of the prospectus, they urgently renewed their request for a meeting. Only on December 14, 1978, ten days after consummation of the merger, were Mann and his colleagues finally told their mill would definitely be closed. Not until January 19, 1979, did J & L management sit down with Local 1462 representatives to discuss whether anything could be done to save Brier Hill. As if in symbolic recapitulation of all that had gone before, Mayor Phillip Richley of Youngstown, two representatives of Congressman Lyle Williams, and an aide to Senator Kennedy, all of whom had been invited to attend by the union, were excluded from the meeting by J & L.

What is the moral? The moral is that unilateral, abrupt, and ruthless investment decisions are made by all kinds of corporations, not just conglomerate. The Campbell Works was closed by a "bad" conglomerate: a conglomerate based outside the steel industry, which used its cash flow from steel for other conglomerate acquisitions. Brier Hill Works was closed by a "good" conglomerate: a conglomerate which has made its steel subsidiary the third ranking company in that industry. And the Ohio and McDonald Works in Youngstown are about to be closed by a steel company ordinarily not considered a conglomerate at all, although, last year, more than a quarter of United States Steel's earnings came from sources outside steel, and between 1976 and 1979 United States Steel's nonsteel assets grew 80 per cent to 4.6 billion while steel assets increased only 13 per cent to $5.9 billion.[9] You have heard how Lykes "milked" Youngstown Sheet & Tube rather than reinvesting its earnings in steel. How is it any different when United States Steel refuses to modernize its Ohio Works and on November 27, 1979, announces their closure, while two weeks later it announces plans to build two chemical plants in the Houston area as a joint venture with Tenneco Chemicals?[10]

The problem is not conglomerates. The problem is unregulated investment decisionmaking by corporations of all kinds.

Reverend **Rawlings**. John Greenman has more details on this story.

TESTIMONY OF JOHN F. GREENMAN, URBAN AFFAIRS EDITOR, TRIBUNE CHRONICLE, WARREN, OHIO

Mr. **Greenman**. Mr. Chairman, my name is John F. Greenman. I am the urban affairs editor of the Tribune Chronicle, a small daily newspaper in Warren, Ohio.

Late last year our newspaper published a series of stories reporting a 6-month investigation of the Justice Department's approval of the Lykes-LTV merger. I have provided the subcommittee with a copy of that series for the record. I would like to briefly summarize our conclusions.

[Articles retained in subcommittee files.]

Mr. **Greenman**. Former U.S. Attorney General Griffin B. Bell's approval of the Lykes-LTV merger 19 months ago was a disputed decision tainted by a breach in the U.S. Department of Justice, the consequent disregard of key facts, and corporate and political maneuvering.

Bell's approval is an example of Federal decisionmaking at its worst.

A 6-month investigation by the Tribune Chronicle found that:

---

[8] Joint Proxy Statement for Annual Meeting of Stockholders of the LTV Corp. and Special Meeting of Stockholders of Lykes Corp., Oct. 27, 1978, p. 10.

[9] "Big Steel's Liquidation," Business Week, Sept. 17, 1979, page, 89.

[10] Youngstown Vindicator, Dec. 14, 1979.

One, Bell alternately overlooked, devalued, or ignored the findings of his investigative staff because he considered them "messianics";

Two, instead, he believed the corporations, despite evidence that they submitted information riddled with discrepancies and contradictions;

Three, although the Federal Trade Commission was "troubled" by Bell's decision, it declined to reinvestigate because political pressure was exerted on it by the U.S. Department of Justice;

Four, the Department of Justice denied the public and the FTC access to the merger documents to conceal disharmony and to avoid embarrassment to Bell and the Department; and

Five, LTV, the surviving company of the merger, contributed $10,000 to the Democratic National Committee shortly after seeking the merger and another $10,000 just after the merger was approved.

Bell consented to the merger on June 21, 1978, on the grounds that Lykes was a failing company. In a press statement, Bell acknowledged that the antitrust staff and chief recommended against approval of the merger but that all agreed that it was a very close question.

At best, Mr. Chairman, this was an exaggeration; at worst, a lie.

Far from being the dispassionate examination of facts and law implied by Bell's June 21 statement, the decisionmaking process was marked by virulence and acrimony.

Virtually no one in the Department, least of all the antitrust staff and Bell, regarded the merger decision as close. To the contrary, the antitrust staff and Bell fundamentally disagreed on all significant substantive issues: The facts in the case, the meaning of the facts, and the requirements of Federal antitrust law.

Moreover, they disagreed on procedural matters. The antitrust staff believed that it should treat Lykes and LTV as adversaries, not allies, as Bell believed.

The antitrust staff believed that it should treat what the "companies tell us with suspicion," not "put more faith in what they tell you," as Bell believed.

The antitrust staff believed that its role was to enforce Federal antitrust laws, not help "businessmen who are in trouble," as Bell believed.

The disagreement on procedural issues led Bell to regard the antitrust staff as "messianics" whose judgment could not be trusted. Consequently, Bell alternately overlooked, devalued, or ignored the antitrust staff's position on substantive issues. Consequently, Bell overruled the antitrust staff and approved the merger.

The Tribune Chronicle's examination was undertaken last July in an effort to answer three questions: One, what led the antitrust staff to conclude that the merger was illegal and to recommend that the merger be denied? Two, what led Bell to overrule the antitrust staff and approve the merger? Three, who was correct?

Until recently, Mr. Chairman, it was not possible to answer these questions. The answers were buried in a mass of corporate and Government documents that the Justice Department possessed but refused to release.

The Department did so by denying freedom of information requests filed by 14 organizations, including the Tribune.

Not only were newsgathering organizations barred from examining the Department's merger files, so were academicians, public interest groups, and Federal officials outside the Justice Department.

Also, until recently the principals in the case—Eric F. Kaplan, the lead investigator; John H. Shenefield, the Assistant Attorney General in charge of the Antitrust Division; and Bell—were unwilling to discuss the decisionmaking process in depth and on the record.

But in early July the Department's policy on release of its merger files changed. In response to an FOI appeal filed by the Tribune and others, the Department released 897 pages of corporate and Government documents from its merger files. The documents released by the Department were said to contain all the facts in the case.

Also, in early July it was clear that Bell was about to leave the Justice Department and the principals in the case agreed to interviews.

Additional information was obtained from corporation lawyers, bankers, and consultants, other members of the antitrust staff and Government officials outside the Department.

The series of stories that the Tribune published last month was based on the information gleaned from the released documents and on information elicited from interviews.

That concludes my statement.

[Mr. Greenman's prepared statement follows:]

Prepared Statement of John F. Greenman, Urban Affairs Editor, Tribune-Chronicle, Warren, Ohio

Former U.S. Attorney General Griffin B. Bell's approval of the Lykes-LTV merger one year ago was a disputed decision tainted by a breach in the U.S. Department of Justice, the consequent disregard of key facts, and corporate maneuvering.

A six-month investigation by The Tribune found that:

Bell alternately overlooked, devalued or ignored the findings of his investigative staff because he considered them "messianics."

Instead, he believed the corporations despite evidence that they submitted information riddled with discrepancies and contradictions.

Although the Federal Trade Commission was "troubled" by Bell's decision it declined to re-investigate because political pressure was exerted by the Department of Justice.

The Department of Justice denied the public and the FTC access to the merger documents to conceal disharmony and to avoid embarrassment to Bell and the department.

LTV, the surviving company of the merger, contributed $10,000 to the Democratic National Committee shortly after seeking the merger and another $10,000 just after the merger was approved.

Bell consented to the merger on June 21, 1978, on the grounds that Lykes was a "failing company." In a press statement, Bell acknowledged that the antitrust staff and chief recommended against approval of the merger, but that all "agreed that it was a very close question."

At best this was an exaggeration, at worst a lie.

Far from being the dispassionate examination of facts and law implied by Bell's June 21 statement, the decision making process was marked by virulence and acrimony.

Virtually no one in the department least of all the antitrust staff and Bell regarded the merger decision as close.

To the contrary, the antitrust staff and Bell fundamentally disagreed on all, significant, substantive issues: the facts in the case, the meaning of the facts, and the requirements of federal antitrust law.

Moreover, they disagreed on procedural matters:

The antitrust staff believed it should treat Lykes and LTV as "adversaries," not "allies" as Bell believed.

The antitrust staff believed it should "treat what (the companies) tell us with suspicion," not "put more faith in what they tell you" as Bell believed.

The antitrust staff believed its role was to enforce federal antitrust laws, not help "businessmen who are in trouble" as Bell believed.

The disagreement on procedural issues led Bell to regard the antitrust staff as "messianics" whose judgment could not be trusted. Consequently, Bell alternately overlooked, devalued or ignored the antitrust staff's position on substantive issues.

And consequently, Bell overruled the antitrust staff and approved the merger.

The Tribune examination was undertaken last July in an effort to answer three questions:

What led the antitrust staff to conclude that the merger was illegal, and to recommend that the merger be denied?

What led Bell to overrule the antitrust staff and approve the merger?

Who was correct?

Until recently, it was not possible to answer these questions. The answers were buried in a morass of corporate and government documents that the Justice Department possessed, but refused to release. The department did so by denying Freedom of Information requests filed by 14 organizations, including The Tribune.

Not only were news gathering organizations barred from examining the department's merger files, so were academicians, public interest groups, and federal officials outside the department.

Also until recently, the principals in the case—Eric F. Kaplan, the lead investigator; John H. Shenefield, the assistant attorney general in charge of the antitrust division; and Bell—were unwilling to discuss the decision making process in depth and on the record.

But in early July, the department's policy on release of its merger files changed. In response to an FOI appeal filed by The Tribune, the department released 897 pages of corporate and government documents from its merger file. The documents released by the department were said to contain "all the facts" in the case.

Also in early July, it was clear that Bell was about to leave the Justice Department, and the principals in the case agreed to interviews.

Additional information was obtained from the corporations' lawyers, bankers and consultants; other members of the antitrust staff; and government officials outside the department.

This series of stories is based on the information gleened from the released documents, and on information elicited from the interviews.

TESTIMONY OF REV. CHARLES W. RAWLINGS, OFFICER FOR CHURCH AND SOCIETY OF THE EPISCOPAL DIOCESE OF OHIO

Reverend **Rawlings**. Mr. Chairman, I have lived inside this story for 2½ years, and I find myself, as I suspect you do, depressed as I hear it recounted again. Unfortunately, my testimony simply unfolds yet another dismal aspect of what has resulted in the loss of 10,000 steel jobs in the Youngstown area.

You have heard testimony concerning the destructive and negative role played by Attorney General Bell in overruling his Antitrust Division concerning the merger of Lykes and LTV.

Had that merger been avoided, as Government experts thought lawful and appropriate, Youngstown not only would not have lost the Brier Hill steel mill but circumstances would have been more encouraging for the revival of the Campbell Works of Youngstown Sheet & Tube.

It was the attempt to revive the Campbell Works under a cooperative organized through employee stock ownership and community ownership that was the focus of a national and local effort by the Roman Catholic, Jewish, and Protestant churches.

An Ecumenical Coalition worked with both the local and international union to create the revival of that vast mill. My testimony is about the Government's role in preventing that from happening. It is a story of dishonest and cynical behavior.

I hope my testimony will justify for you and the other members of this subcommittee such a strong characterization.

About 2 months after "Black Monday" struck Youngstown in late September 1977, Robert Hall, Assistant Secretary for Economic Development, convened a meeting in his offices at the Department of Commerce with Youngstown government, religious, and civic leaders.

At that meeting Mr. Hall set forth EDA's criteria for assisting Youngstown in an effort to plan the reopening of the Campbell Works. He insisted that there must be a unified entity to which the Government could relate if any progress were to be made. He spoke of the need for a partnership between the Federal Government and the local community.

I am sure, Mr. Chairman, you will agree that creating unity in the complex matrix of forces and interests in any local area is a difficult, indeed rare event.

However, because of the vital leadership of Roman Catholic Bishop James Malone and other local religious leaders, all major parties in the Youngstown situation signed a letter to Robert Hall on December 23, 1977, agreeing that the Ecumenical Coalition would receive grants from HUD for studies preparatory to reopening the Campbell Works.

The letter was signed by the then Mayor Philip Richley, the then Congressman Charles J. Carney, Frank Lesaganich, director of district 26, United Steelworkers of America, and Bishop Malone. I include the letter as an attachment with this testimony. [See Appendix I.]

A unique and extraordinary community effort unfolded to redeem the result of the corporate mergers and acquisitions that were destroying the great steelmaking center of Youngstown. The national religious community donated over $300,000 to the effort.

Citizens of Youngstown deposited over $4 million in "Save Our Valley" savings accounts in area banks as a show of equity potential to help finance the new undertaking. HUD provided a grant for a feasibility study of some $200,000 and a grant a year later—partly to offset the adverse effects of the merger on earlier calculations—of about $100,000, which paid for a market study.

In October 1978, Robert Hall told a meeting held at the White House and composed of Youngstown leaders and the Ecumenical Coalition that he was making $100 million in loan guarantees available to a "viable steel project" in the Mahoning Valley.

Following the same meeting, Presidential Assistant Jack Watson told reporters from the Washington Post and the Youngstown Vindicator that $300 million was not out of the question. It was, of course, less than a month away from the fall elections.

Mr. Chairman, the rest of the story is composed of the round-the-clock efforts of Youngstown leaders—stretching from October to the end of March 1979—to prepare and refine their proposal for the reopening of the Campbell Works.

Unemployed steelworkers were gathered together in a new group with whom informal negotiations could take place about labor costs. Steel engineers and managers were called together for consultation—some of the chief operators of the mill before closure.

Steel economists and several corporate law firms, a Wall Street investment banking house and hundreds of local citizens tackled this complex effort within the Government.

In January there was a first sign of a change of wind. EDA leaked a report prepared for it which evaluated the feasibility study prepared for the Coalition before it was faced with the new economic realities of the merger of Lykes and LTV.

The study in effect evaluated what was a premerger design in light of postmerger realities. It was a sure sign that someone in the Government did not want Youngstown to succeed.

We simply responded that the evaluation, which was negative in part, did not assess our new feasibility studies which were being made in light of the merger realities and was therefore not relevant.

We plunged on, reassured by our memories of Mr. Hall's need for community unity and the promises he and Jack Watson had made in October 1978.

In mid-March we approached EDA with a proposal that had been endorsed by a president of a fully integrated steel company in this country, endorsed by experience operating engineers in the steel industry, which offered a major achievement and breakthrough in labor costs.

Through the good offices of the international office of the United Steelworkers of America, a 21-percent reduction in labor costs had been negotiated with local steelworkers who would potentially work in the new mill.

Not only did we offer added incentive to worker productivity through worker ownership of the mill, but even before the first sheet of steel was rolled workers agreed to concessions that saved major dollars for this new effort.

We presented these findings to EDA officials on March 21, 1979, in a full dress meeting at the Department of Commerce chaired by Robert Hall. There were very few questions. Seven days later, under date of March 29, Bishop Malone and the leaders of Youngstown received a letter signed with a rubber stamp imprinting Robert Hall's name and informing the Coalition that EDA and the Government could offer no assistance to this 18-month effort to a unified Youngstown community, which they had inspired and provided guidelines and that prompted endless community effort in Youngstown.

Let me now summarize both the Government's conclusions and what we learned about their conduct in this matter through the Freedom of Information Act and information we received through its provisions. I shall also summarize what EDA and Mr. Hall have been doing to Youngstown since that time.

One. The Coalition had proposed a reopening and modernization package of $245 million in loan guarantees. Mr. Hall claimed his principal and overriding objection was because that exceeded the loan guarantee ceiling in the special steel loan guarantee program.

He also claimed the Youngstown proposal lacked sufficient assurance of economic viability. He cited questions about capital cost estimates, available markets, the management team proposed and general financial feasibility, questions which he never raised during the long planning period but were raised only when he wrote us to say no. So, the Coalition never had a chance to respond.

Two. The Ecumenical Coalition countered with a proposal for a phased reopening and modernization to stay within the loan guarantee guidelines. Mr. Hall replied—in what must be the decade's most notable catch-22—that the loan guarantee program could only be made available to fully integrated companies and phasing would disqualify us.

Three. Through Freedom of Information inquiries, attorneys for the Ecumenical Coalition learned that there were considerable Department memorandums on the Youngstown proposal in the EDA files, including a 13-page set of critical comments which had never been shared with the Coalition consultants, and to which we never had an opportunity to respond.

Four. But in a further Freedom of Information inquiry, our attorneys discovered a 12-inch-thick file of exchanges between Wheeling-Pittsburgh Steel and EDA concerning that company's application for Federal loan guarantees.

I have with me today, Mr. Chairman, just a three-fourths of an inch sample of that file. Compare, if you will, the manner in which EDA was partner to Wheeling-Pittsburgh in that company's application for loan guarantees and the ultimate perfection of their application. Compare this with the fact that Youngstown received no memorandums, no correspondence, no opportunity to respond to critical commentary in its application for loan guarantees.

Five. The role of EDA since March 29 has been to seek a compensating solution for its sad performance in Youngstown. Apparently seeking to maintain its religious image, it hired Rev. William Hogan, a steel historian and economist at Fordham University, to design an alternative for Youngstown.

Father Hogan, noted for his uncritical views of the American steel industry, has proposed that Youngstown might be the site of a large coke battery employing 300 to 600 persons.

Laying aside for a moment the fact that this would hardly seem an answer in a community that is now losing 10,000 jobs in basic steel alone, the overriding characteristic of the Hogan/EDA coke battery is that Youngstown will shortly have no more blast furnaces in which to use the coke. But that does not complete the irony.

Six. EDA has announced that it could make $100 million in loan guarantees for its Youngstown coke battery available even though it would not be an integrated steelmaking facility, when we suggested a phased redevelopment. It announced it would do this because it would make an exception in its guidelines in this instance.

Mr. Chairman, I trust this subcommittee of the Small Business Committee does not miss the message in such maneuvers for small business and economic development needs in this country.

As I understand it, EDA has played a role in this entire matter that fluctuated between serving as an instrument of political campaign opportunity—the Hall-Watson pledge of $100 to $300 million in loan guarantees in October 1978, a month before the election—to functioning as the handmaiden of the giants in the steel industry.

The only purpose of Youngstown's coke battery proposed by Father Hogan and Mr. Hall is to provide a government prop for the very largest steelmakers in the country. One need only look at the opportunity United States Steel would derive from that battery for its proposed giant mill at Conneaut, Ohio.

Mr. Chairman, I conclude my testimony by once again pointing out that had this Government through its Justice Department and Economic Development Agency blocked the destructive mergers in Youngstown and the industry bootshining characterized by Robert Hall's policies, Youngstown could now be celebrating the reopening of the Campbell Works, the Brier Hill works would never have been closed, and small businesses and local economic development in this country would have a chance for creative entrepreneurship.

EDA is back in Youngstown again and is touting the idea of industrial diversification. That is never a bad idea, and all of us are for it.

But in Youngstown, where the last blast furnaces are about to go down, EDA's posture sounds more like the steel industry position than a government agency fighting to keep the community it serves alive.

Thank you.

Mr. **Bedell.** Thank you for all your testimony. There has been so much, I think we are going to have trouble kind of keeping our thoughts together.

First of all, we are glad to welcome you, Congressman Williams. Before we get to questions, is it correct that they prohibited you from attending this meeting?

Mr. **Williams.** Yes; that is absolutely correct.

Mr. Chairman, I want to thank you for giving me the opportunity to sit in. I think these gentlemen have best described what has happened in the valley.

Mr. **Bedell.** How did they justify prohibiting a Member of Congress from being able to meet with them?

Mr. **Williams.** They have not justified, I don't believe, anything.

Mr. **Bedell.** This is the J. & L. management that refused to meet with you?

Mr. **Williams.** That is correct.

Mr. **Bedell.** Was this some kind of a board meeting they were having that you wanted to attend?

Mr. **Williams.** It was a meeting they had agreed to between the local labor group there and we wanted to have local representatives there along with Senator Kennedy and Mayor Richley from Youngstown.

They refused to meet until our people left and did not permit our people in, any of those, including myself and the mayor.

Mr. **Bedell.** I don't think I have ever heard of anything like that before.

Mr. Tauke, you may go ahead.

Mr. **Tauke.** Gentlemen, you have quite a story to tell.

Mr. Chairman, I hardly know where to begin. But let us start with the beginning.

The merger between Lykes and Youngstown Sheet & Tube. Apparently the reason for this merger from the standpoint of Lykes was the ability to gain a relatively good cash flow situation out of Youngstown Sheet & Tube, as I understand it.

Why did Youngstown Sheet & Tube decide to go along? Why did they want to enter into this kind of arrangement?

Mr. KELLY. I looked at the records of the board meetings of Sheet & Tube in 1968. There was quite a bit of controversy about whether or not they should go along with this.

The problem was that the steel industry in general and Youngstown in particular were targets of a lot of companies trying to make takeovers. I think that partly they sort of felt it was inevitable that they were going to get taken over by somebody. There was a tendency to think that.

I think also they were given some assurances by Lykes that the steel business would be continued in an adequate fashion, that management control was still going to be in the hands of steel people, which was subsequently pretty much proved to be false, and so they were partly surrendering to what they thought was inevitability and partly I think they were lied to on the part of Lykes as to what the future was going to be like.

So, they were finally given an order that was quite lucrative and they upped the offer once. The first offer they refused and then they got a higher bid and they finally went along with it.

Mr. BEDELL. Will you yield?

Mr. TAUKE. Go ahead.

Mr. BEDELL. Was this a stock exchange or cash sale?

Mr. KELLY. Lykes first bought a fairly large amount of Sheet & Tube stock prior to the actual takeover, so they were already a fairly large stockholder.

Then they offered a combination of preferred stock and debentures to the stockholders. Apparently it was in excess of what the common stock was worth on the stock exchange and the total value of the debentures and the preferred stock.

So they went along with it. There was some dissent at the time. There were some long-time, fairly significant stockholders in the Youngstown area who were very upset about the merger and did not want to go along with it. There was dissension within the stockholders and the directors right up to the time of the merger.

Mr. TAUKE. It would occur to me that the stockholders of Youngstown Sheet & Tube have been able to figure out—and, of course, hindsight is always quite accurate—but it occurred to me they should be able to figure out that a company was going to borrow this much money and go that far into debt to take over was going to face some difficult problems down the road.

The security for Youngstown Sheet & Tube certainly was not very good.

Mr. KELLY. You would have thought so.

Mr. TAUKE. Then they must have got a very attractive deal, the stockholders. Just how attractive was it? What was the value of Youngstown Sheet & Tube? What was the value of the stock and what was the price that the stockholders were getting in a sense?

Mr. KELLY. I don't recall the specific price, but I do recall that the overall value of the offer, the first time around, was considerably in excess of what the common stock was selling for.

They rejected that one and Lykes came back with a second one, which was also accompanied by the promises that they would do good things with the steel side of the business.

The second one was considerably in excess of what the stock was selling for at the time. It was quite a lot higher than what they could have sold their stock for on the stock exchange.

It is hard to go back and pull together the motivation for some of these things on the basis of directors' meetings, which is the only thing I have had a chance to examine in detail.

Mr. TAUKE. Was this whole thing a good deal for Lykes? Why did they want to get into it? It apparently didn't turn out so well.

Mr. GREENMAN. I think I can add one piece of information to this. It was only 9 years after the consummation of the Lykes Sheet & Tube merger that George Schueller's opposition to the merger from the Justice Department came out and that the dissension among board members of Youngstown Sheet & Tube came out. [See Appendix H.]

When the merger was proposed to shareholders, the phrase used to describe the merger was "a marriage" that would be profitable to both Lykes and to Sheet & Tube, and that the dissension that was heard in the board room was never presented to the shareholders of Youngstown Sheet & Tube, who were a diverse and heterogeneous group of small and large holders throughout the country.

If there was a failure, there was a failure on the part of the dissident members of the board not to bring out what they anticipated were the problems.

If there was a second failure, it was a failure on the part of the Justice Department not to say, well, there is some difference of opinion about this merger and if there was a third failure, it was on the part of the shareholders back in 1969 to look very carefully at the debt structure of the merged firm and say this is clearly the tail of the dog and that it is bad for us and that we should not support it.

Mr. TAUKE. I think as we have gone through these things the past couple of days, the thing that I have been trying to find out is what is the motivation for this kind of thing. What is the motivation for the two parties involved?

It is fairly difficult to see at this point exactly what the motivation was for either Youngstown Sheet & Tube or for Lykes.

Mr. GREENMAN. In 1969?

Mr. TAUKE. Yes.

Mr. GREENMAN. Our information, as we reported the story, was that Lykes saw the availability of $100 million in cash flow and that all they exchanged for that was mortgaging its future. My sense is that Lykes, like so many of us, was willing to accept in the present a windfall, sensing that the losses were perhaps down the road.

I think for Sheet & Tube the advantage was that here was a firm that was going to acquire us anyway. They were buying stock on the open market, and that we had cut a deal with them whereby they would simply be a holding company with a steel firm and that steelmakers would continue to operate this firm.

That was their assurance. So they simply saw it, I guess, as the lesser of two evils.

Mr. **Bedell.** Isn't it also true that the shareholders of Youngstown, in accepting the order from Lykes, would get substantially more money than if they were to sell their stock on the open market?

Mr. **Greenman.** That is the case.

Mr. **Bedell.** So, in the short term, they had stock worth $10, if they were to sell it, that they were offered $15 for in the form of debentures and stock, is that correct?

Mr. **Greenman.** That is correct.

Mr. **Bedell.** I think the motivation was from the stockholders who were more concerned about their own financial position than what was going to happen 5 or 10 years down the road with the company.

Reverend **Rawlings.** Mr. Chairman, may I make an additional comment on the company? I will cite the old law that all that glitters is not gold.

It seems to me there is a lot of that chasing of the Holy Grail in some of these business deals. For example, if you go back and look at an earlier period of the Sheet & Tube company's performance, the Campbell Mills were a highly profitable and competent operation.

The company got the idea that it would be a fine thing to build a new mill up on the shores of Lake Michigan. They undertook the Indiana Harbor complex. It drained a lot of money away from their Campbell operations and it became an operation in Indiana Harbor with a lot of problems, a lot of difficulties getting the knots untangled.

It seems to me that perhaps the wonderful wisdom in the small business community about how to do business sometimes would be better used in some of these larger corporate and conglomerate arrangements.

Here was a company that was solid in the Mahoning Valley and went over in a greenfield venture on the shores of Lake Michigan, got in trouble with that, drained its money, found a conglomerate merger attractive and what was a sound business, and we think could be resurrected again as a sound business, was lost.

Mr. **Tauke.** What did Lykes do with the $100 million a year cash flow?

Mr. **Kelly.** Three things happened.

First of all, in the early 1970's the steel business declined. They were bad years for steel so that the cash flow declined somewhat from the $100 million figure.

They had to spend $40 million a year out of that to pay interest on the debt. Part of that also went, we think, to repaying some of the debt.

The third thing was that they continued to diversify into insurance, electronics, and a few other areas.

The thing is that Lykes had been sort of caught up in the spirit of becoming a conglomerate. It was coming out of the 1960's when everybody wanted to become a conglomerate.

They were a staid, old shipping company that never did anything but run ships for 50 years. They brought in their first outside manager that they had ever had. One of the Lykes brothers had always run it. An outside manager came in and convinced the

Lykes family that they should become a conglomerate, that that was the thing to do.

I don't think he was so competent. I don't think the Lykes people themselves had much of an idea of how to do anything except run shipping companies. They took the control out of the steel side of it.

To contrast a little bit, when Jones & Laughlin Steel was taken over by LTV, when that was taken over, the steel business of Jones & Laughlin was still largely under the control of the Jones & Laughlin management. That conglomerate let the steel business alone to some extent.

But in the Lykes situation, very minor decisions that should have been made by middle management at the plant had to be checked with New Orleans executives who were not even steel people. All sorts of stuff like that went on that meant a total ignoring of the steel business. They thought they could get away with not modernizing.

Mr. TAUKE. There were two basic problems. Capital was pulled away from the steel business and second, there was bad management.

It seems that ever since we have looked at where we have had this problem, it has been a problem where the parent company that takes over gets involved in the management of the subsidiary and they don't have an appreciation for that kind of business.

Mr. KELLY. That is right.

Mr. TAUKE. Let's move on to the next merger between Lykes and LTV. I take it that in this case it was necessary for Lykes to find some kind of help from elsewhere and that is why this one took place.

Mr. LYND. So they claimed.

Mr. TAUKE. You say that somewhat skeptically.

Mr. LYND. One of the things that Mr. Greenman brings out in his series—and you correct me, John—let's say in April 1978 the Justice Department antitrust investigating team had unanimously concluded that this was not a failing company.

The Lykes board of directors then staged the inception of bankruptcy proceedings at their next board meeting solely for the purpose of making an impression on the Department of Justice.

Mr. TAUKE. Well, why, in your judgment—or again maybe we should ask—what was Lykes getting out of this or the stockholders of Lykes?

Mr. LYND. I can't pretend to deal with that.

Mr. TAUKE. What kind of a merger was it, do you know?

Mr. LYND. I can't answer that, either. I know from the J. & L. point of view they were supplementing their steelmaking. You can look at the map of the physical facilities of the two companies and you can see why it would make some sense to J. & L. to want to own them both.

Sheet & Tube had raw materials in excess that they didn't quite know how to get rid of. J. & L. needed the raw materials. It was this kind of physical thing.

Mr. TAUKE. Do any of you know about this merger?

Mr. GREENMAN. Very clearly, the 1978 merger between Lykes and LTV provided important economic benefits to both corporations. The evaluation by the investment banking firms who were hired to put this merger together was that the merged company would save between $60 and $80 million a year in operating costs as a result of combining both raw materials and steel producing facilities.

There was clearly an economic benefit to the corporations. Both corporations recognized that benefit. The difficulty, of course, is that in gaining that economic benefit for their shareholders, they were reducing competition in the steel business which was detrimental to the public interest, so the Justice Department said.

The Lykes-LTV merger was not a case where the merger was faulty from an economic standpoint, as far as the corporations were concerned, but apparently according to the antitrust staff it was faulty from the standpoint of competition and it was clearly bad from the standpoint of the workers in Youngstown whose jobs were lost as a result of this merger.

Mr. **TAUKE**. Did LTV want to keep the Youngstown merger going because it was helpful to J. & L?

Mr. **GREENMAN**. But they didn't. That is the point.

Mr. **TAUKE**. But I am saying if this was helpful for them and if the merger was great for both companies involved because they could save money, what went wrong, why didn't they keep the Youngstown operation?

Mr. **LYND**. I think the confusion is—and you have to imagine the political geography of the steel industry in Youngstown—there are two mills.

The Campbell Works on the south side did two things. It rolled hot and cold steel sheet. That was its main activity and that was what was shut down in 1977 and cost 4,000 or 5,000 jobs. It has also a seamless pipe mill which is very profitable because the product is sold to the oil industry and the oil industry is booming.

Now, the merged steel company, as a result of the LTV-Lykes merger, has operated up to this point the seamless pipe mill at the Campbell Works in Youngstown. What it has discarded is the other mill in town, the Brier Hill Works, which used to make the components for the pipe.

Instead, they are getting those components from what used to be a J. & L. mill in Aliquippa, further away, but they think cheaper because of its more efficient steelmaking.

Mr. **TAUKE**. So it was simply a good business then on the part of J. & L., once this merger had taken place, to take the actions they did in relation to Brier Hill?

Mr. **LYND**. The position of the Coalition as I tried to describe it in my testimony was not necessarily this particular merger should be opposed because, as John says, this was not a merely exploitive or acquisitive merger.

It made some economic sense, not necessarily from the standpoint of antitrust law but from the standpoint of the steel industry economics. But what we said was that we can foresee 6 months before Mr. Bell made his decision, we can foresee that this is going to mean 1,200 people in Youngstown being out of a job.

We think that that is a serious enough consequence that before permitting the merger, the merged companies should be required to let the U.S. Government make the decision with them, if after the merger they think that decision needs to be made.

We think Brier Hill could have been saved. It could have been changed to independent products or set up as an independent steel company with some timely EDA assistance.

Mr. TAUKE. Basically from the economic point of view, without talking about the social concerns or employment or anything else, LTV and Lykes made appropriate economic decisions, I take it, in what happened with the merger and also with the closure of Brier Hill and foreseeable decisions as a result.

Reverend RAWLINGS. May I comment on that?

Mr. TAUKE. Yes.

Reverend RAWLINGS. I think the statement is true from the point of view of the steel economics of J. & L. and it is true from the point of view of their stockholders. But what these mergers are amounting to is the contraction of steelmaking ability in the United States, and that is another dimension of economics that I think needs to be looked at and monitored very closely.

Mr. TAUKE. I agree. I am just looking at it now from the perspective of the two companies. What would have happened if this merger had not taken place?

Mr. LYND. I think maybe John can best answer that because the antitrust people tried to develop that scenario.

Mr. GREENMAN. I can't tell you what would have happened. I can report to you what the Justice Department as well as two investment banking firms said would happen.

The Justice Department's antitrust staff did not regard Youngstown Sheet & Tube and Lykes, as a combined firm, as a failing company. It was their conclusion that if the merger was denied, with less than $100 million in capital investment plus better management, within 2 years the firm would be operating profitably, that it could continue to operate its Indiana Harbor Works in Indiana, employing 8,400 steelworkers, and it would continue to employ about 4,500 steelworkers at the Campbell plant and at the Brier Hill plant in Youngstown. That was the antitrust staff's conclusion.

That was also the conclusion of two investment banking firms who were interviewed by the antitrust staff.

Lykes, however, claimed that would not occur. Lykes claimed that if the merger was denied, it would be a bankrupt firm and with bankruptcy would come the closing of the Indiana Harbor Works as well as the closing of its Ohio facility, and Bell believed the company.

Mr. BEDELL. Will the gentleman yield?

Mr. TAUKE. Yes.

Mr. BEDELL. What happened to the Indiana Harbor Works?

Mr. GREENMAN. The Indiana Harbor Works, as the antitrust staff predicted, is now profitable. It is one of the ironies of the Justice Department investigation that what the staff said has occurred.

Mr. TAUKE. I have just two more things that came to mind as a result of your testimony. Obviously, we could have gone for hours with questions, but you indicated, first of all, that the Federal Trade Commission was troubled by Bell's decision but it declined to reinvestigate because political pressure was exerted from the Department of Justice.

Could you elaborate on that?

Mr. **Greenman**. Yes.

Approximately 3½ months after Bell approved the merger, Senator Kennedy, as chairman of the Antitrust Subcommittee, asked the Federal Trade Commission to reexamine this merger. That request was staffed by the Federal Trade Commission's Bureau of Competition. Apparently, it was wired up in advance.

The information that I obtained showed that the FTC's Bureau of Competition went to Kennedy's staff and said, "Look, here is how we can best deal with the merger. You send us a strong letter asking us to look at Bell's decision and we will do it."

However, once that letter went across, John Shenefield, the Antitrust Chief, as well as his deputy, Guy B. Ewing, went to the Bureau of Competition and said, we suggest very strongly to you gentlemen that you turn this down and we will give you a good reason why.

The reason is that on Capitol Hill there is serious concern about the fact that two agencies of Government examine antitrust: one, the antitrust staff and, the other, the Federal Trade Commission, and what it might come down to, if you have this one agency looking over the shoulder of another, that Capitol Hill will say, well, maybe we should just have one antitrust enforcement agency.

Shenefield said to the Federal Trade Commission, if it comes down to that, you know who is going to lose. The people that I talked with in the Bureau of Competition on the record said, we had problems with this merger, we didn't believe Bell or his assertions about the failing company but ultimately, and the quote was, "it was not worth taking the flak." That flak would have been injurious to their future and that is why they did not reexamine the merger.

Mr. **Tauke**. Another allegation or conclusion that you indicated was that LTV contributed $10,000 to the Democratic Committee after seeking the merger and another $10,000 just after the merger was approved.

How can LTV contribute any money to a political party?

Mr. **Greenman**. LTV did so through its political action committees. The contributions were legal. There is no question about that. There is question, however, as to LTV's motivation in making these contributions.

Two people reported to us that the first contribution was made to influence Bell's decision. The second contribution was made to reward a correct decision. There is no evidence that they had that effect on Bell, that is, according to Bell and others.

LTV denied to us that was their intention. However, LTV has a long history, as do other corporations and labor unions and everyone else, of attempting with campaign contributions to influence Federal decisionmaking.

Our examination of LTV contributions over the last 4 years showed that they put their money with chairmen of congressional committees, Senate and House committees that have jurisdiction over their lines of business. They make what you might call smart investments.

It was our sense that in contributing this money to the DNC they were again making a smart investment, especially since the leaders of that corporation are principally Republicans and have put their private money largely with Republican interests.

They showed in advance of this no particular proclivity to Democratic policies toward the steel industry. It just seemed more than a coincidence.

Mr. TAUKE. Mr. Chairman, I have many other questions but let us move on.

Thank you.

Mr. BEDELL. Mr. Williams, would you like to ask some questions?

Mr. WILLIAMS. Yes.

Once again, Mr. Chairman, I thank you for the opportunity to sit in on these hearings. There is a dimension here that I would like to bring out for the record. That dimension is that since the merger has taken place the community of the Mahoning Valley has been trying to recover in the best way we know how by some type of effort to retain the steel industry which has been viable in the valley. Keeping all this in mind, the thing that has been most discouraging to me as the elected official at the Federal level and to these people who have been close to the situation on a local level, is that we find it difficult to deal with the corporate individuals and groups in order to attract small business or other industry to replace what we have lost.

I don't believe there is any question that those individuals in the decisionmaking position in these corporations discourage the sale of these properties to potential investors, whether they are small business people or another steel-producing firm. They are concerned about a competitor competing with them.

Last night Mr. Roderick, the chairman of the board of United States Steel, said he would not sell any of those facilities to anyone who was going to compete with United States Steel. [See Appendix J.]

Now, I think this committee has jurisdiction in that area; I am hopeful it does, because I believe United States Steel is discouraging to the development of small business in some of those facilities.

United States Steel, J. & L. or Lykes-LTV is not interested in operating any of these facilities, and we have heard testimony to that extent. Do they have the right, while they are making public statements saying all these properties are for sale, to discourage the actual sale of these properties as we try to diversify or to attract an industry, small business or large business?

I would hope that the committee would, under your leadership, Mr. Chairman, take a look at what is happening since these decisions have put steel companies out of business. In a discussion I had recently with J. & L. officials from Pittsburgh they said they are not interested in selling these facilities to any competitor in any way, shape, or form, whether he or she is small business or major business. It is a difficult problem.

I don't know if the gentlemen would like to comment, one of them or all of them, about this, but it is another dimension that is really dampening the efforts to permit the community of the Mahoning Valley to recover.

Let's set everything else aside and say they don't want to be in business. How do we recover if they are going to take the position that they don't want to sell any of these facilities to anyone else in a steel-related business? That Valley has been in the steel business for years. We have many small fabricating facilities. It is steel-related industries in the Valley. One of the largest aluminum industries in the country is in the Valley. Yet, we have hundreds of acres now that major corporations, United States Steel and others, do not want and we cannot get access to them to develop them.

Would one of you like to comment?

Mr. **Lynd**. I would like to comment, if I might, for a moment, Mr. Chairman.

One of the questions raised with your staff prior to this morning was how the committee was defining a conglomerate, because United States Steel in the last 3 years, according to Business Week magazine, increased its nonsteel assets 80 percent to $4.7 billion while its steel assets increased only 13 percent to $5.9 billion.

Two or three weeks after the announced shutdown of the Ohio and MacDonald Works it announced that it was joining the Tenneco Co. in building two chemical plants as joint ventures near Houston, Tex.

United States Steel may very well meet whatever definition of a conglomerate your committee is using, and if it does, we would urge you to call its officers before you to deal with the matter that the Congressman has mentioned.

On Tuesday of this last week the Youngstown district superintendent of United States Steel and its local public relations man met with local union leaders and told them, we are going to keep these two mills, two mills we have not talked about this morning, the next two mills to be shut down, we are going to keep these two mills intact until June. We will not tear out the machinery and send it someplace else. We are going to have our realty company in Elwood City, Pa., come in and make an appraisal of the value of the property and then we will listen to your offer as we would listen to any other. That is what they were told on Tuesday by United States Steel's local people.

On Thursday, Mr. Roderick was here in Washington for the press conference of the American Iron & Steel Institute and told both Youngstown press and TV people, no, that is no go, we won't sell to any employee-formed corporation that takes Government subsidies and that competes with us.

It seems to me that if, on the one hand, United States Steel should interest you as a conglomerate, on the other hand it should interest you as an antitrust committee as an outfit that is refusing to sell to a competitor.

Mr. **Williams**. Just to add one further thought to this new dimension, we feel pretty certain that the Brier Hill Works is an attractive facility for steel producers, interested steel producers, in this country. I don't see any way for anyone to obtain that facility, although they have written it off and closed it and plan not to operate it for the reasons that you have heard, more profitable in Indiana Harbor, it is a good business decision for that particular company.

We have interest in that facility. I don't know how to go about buying the facility for another steel producer. It is going to be impossible unless we are able in some way through Government and antitrust laws to force these people to sell these facilities. They are on the market. They will make public statements that they are for sale, but when we have a competitor that wants to buy them, they absolutely refuse to sell these facilities.

It is a very, very complex and difficult problem. I think we are painting a picture for you that is probably somewhat unbelievable, but it is very believable and we can produce the public statements made by the chairman of the board of United States Steel and other individuals who will not deny it.

Mr. **Bedell**. If the gentleman will yield——

Mr. **Williams**. Yes.

Mr. **Bedell**. How much steel production does LTV control at this time? Is LTV heavy in steel?

Mr. **Williams**. They have about 3,500 employees in the Valley with the seamless facility and the coke facility.

Reverend **Rawlings**. They are the third largest steel operation in the country.

Mr. **Williams**. But in our area they have about 3,500.

Mr. **Bedell**. How large is your Valley?

Mr. **Williams**. Youngstown is about 150,000. Mahoning County is 230,000 and Trumble County is 270,000.

Mr. **Bedell**. So you have lost how many jobs?

Mr. **Williams**. Around 12,000.

Mr. **Bedell**. If United States Steel were to close its plants, how many more would be lost?

Mr. **Williams**. That is including United States Steel.

Mr. **Bedell**. Has United States Steel closed a number of plants?

Reverend **Rawlings**. They announced the closing of two mills and gave the local union a shutdown schedule which begins the middle of the month of February.

Mr. **Bedell**. I presume that is a whole different story we haven't heard about?

Reverend **Rawlings**. That is right. You are beginning to hear it.

Mr. **Bedell**. Are there problems with that?

Mr. **Williams**. Absolutely.

Mr. **Greenman**. Not in terms of merger, but otherwise, yes.

Mr. **Bedell**. That is what I am saying, are there any questions about any Government action in that closing that you may question?

Reverend **Rawlings**. I could say a couple of things about that, Mr. Chairman, to preface a remark by saying, first of all, what we are seeing in the industry is a contraction of productive capability. We see that in the merger that you have heard about this morning, and we see it in the diversification pattern of United States Steel; they are investing increasing amounts of their capital dollars in chemicals and other nonsteel industries.

The consequence of that pattern is that the company fiercely expresses the right to close down its facilities in Youngstown, the Ohio Works, and McDonald Works, which employ, in total, about 3,600 production and maintenance workers, not counting the management folk. But what we are telling you this morning is that they also want the right to block anyone else from making steel in those facilities.

And I think that is a statement that they are making in particular reference to the idea of the community and the workers, acquiring the plants and operating it. These United States Steel facilities have a strong management team in place, and I think that management team would like to keep making steel there; I think they believe they can make steel.

EDA is in the valley, talking about putting money in the coke battery, which at this point, unless it is tied into some creative new plan, is irrelevant, and it is in the Valley talking about diversification. In my judgment, Mr. Chairman, EDA is in the valley as the handmaiden of United States Steel and J. & L. to shut down the steel industry in that Valley.

Mr. Williams. To answer your question or expand on Mr. Rawlings' remarks, Mr. Chairman, yes, I think Government has something, or should have something, to say, and that is the point I am trying to make. This is a dimension I believe this committee can deal directly with along with conglomerate mergers. Maybe another subcommittee should be involved.

I wanted to get in the record that they are discouraging the activity of nine small business communities by refusing to sell to people whom they do not want to sell to. Therefore, yes, I think it is important that it is included in the record, and if this subcommittee does not have authority to deal with this, I hope bringing it before you would encourage you to assist me, or whoever, as we try to focus attention on the small business communities and the fact that refusing to sell is hampering their efforts.

Mr. Tauke. Will the gentleman yield?

Mr. Williams. I will be happy to yield.

Mr. Tauke. Is it correct that the Federal Government has certified that the reason that these closings are taking place is because of foreign competition and therefore you are receiving some aid of various kinds of assistance?

Mr. Williams. In the J. & L. situations, those workers are receiving tax benefits which have a direct impact on our Valley.

Mr. Tauke. Yet at the same time that is being done, we are seeing the prevention of domestic people from taking over buying those plants and reopening?

Mr. Williams. That is a good point my colleague made.

Mr. Tauke. On the one hand, we are subsidizing with Federal funds because supposedly this is a matter of foreign competition, but we don't provide funds in order to assist domestic producers in opening plants.

Reverend Rawlings. Mr. Chairman, to add to that, for the record, EDA has a combined package of loan guarantees for steel and nonsteel activities in the valley that is almost the exact amount which we needed last March to reopen the Campbell Works.

Mr. Lynd. Or need now to modernize the United States Steel facilities.

Mr. Bedell. You have made some fairly strong charges against EDA and Mr. Hall. Have you testified before other committees on this?

Reverend **Rawlings.** Yes; I gave testimony to the House Trade Subcommittee of the Ways and Means Committee, Mr. Vanik's committee, on December 27, 1979.

Mr. **Bedell.** This last December?

Reverend **Rawlings.** Yes.

Mr. **Bedell.** Do you know if Mr. Hall testified before their committee?

Reverend **Rawlings.** No; Glenn Waldron from EDA testified.

Mr. **Bedell.** Apparently you are acquainted with his testimony, Mr. Williams?

Mr. **Williams.** Yes.

Mr. **Bedell.** Why are we having him instead of Mr. Hall before us.

Mr. **Levine.** The invitation was extended to Mr. Hall, and he is sending a representative.

Mr. **Bedell.** I don't think we should accept that. The charges are against Mr. Hall. I would think that it is up to the subcommittee, but I think we should demand Mr. Hall, himself, to appear before the subcommittee and not send a subordinate. Is there a reason?

Mr. **Rosenberg.** The invitation was sent to Mr. Hall, and we received a letter back from the Department of Commerce to the subcommittee, indicating that he would send a representative who was empowered to speak for him.

Mr. **Bedell.** I think we should request that our staff send a letter under my signature to the Department, telling them there have been serious charges made against Mr. Hall. We do not expect a subordinate to appear before our subcommittee; we expect Mr. Hall to appear before our subcommittee, and if that date is inappropriate, to let us know, and we will be sure that we have a date when he can appear.

Is there any disagreement with that?

Mr. **Williams.** No, Mr. Chairman.

Mr. **Bedell.** I presume we can subpena him if we have to. If I understand the EDA situation correctly, there has been no other Government agency or committee of the Congress that has pursued some of the questions you are raising in regard to that situation; is that correct?

Reverend **Rawlings.** That is my understanding, with this qualification, that next Tuesday, the Senate Select Committee on Small Business is holding a special hearing on the subject of United States Steel's responsibility to Youngstown.

Mr. **Bedell.** Do we know if Mr. Hall will be appearing there?

Reverend **Rawlings.** I do not know.

Mr. **Bedell.** The thing is, I don't think we want to duplicate efforts.

Reverend **Rawlings.** Mr. Chairman, to the best of my knowledge, he is not, but I can't verify that.

Mr. **Bedell.** We do not want to duplicate efforts, but if indeed this has not been done it appears that it is only proper for us, when charges such as this have been made, to bring the person before us to have a chance to either explain what happened or refute the charges. I think the last thing EDA would want to do is send a subordinate if they are going to justify what has been done.

Do you have any problems with this, Mr. Tauke?

Mr. **Tauke**. I agree with the chairman. There have been charges made against other people here, too, including Griffin Bell. But, of course, he is not in Government any more; I don't know that we want to get into all of these things.

Mr. **Bedell**. Mr. Rawlings, it would appear there is some possibility, in your opinion, that if EDA were to take the proper attitude, there might be some possibility of saving both steel production capability and jobs, particularly in regard to the United States Steel situation in your community.

Reverend **Rawlings**. There is a great opportunity in Youngstown right now. We have two plants that are still operating; the workforce is still in place; the management team is still in place. What we need is the finance capability to create a new company that can continue to make steel.

Mr. **Williams**. Just to add to that, Mr. Chairman, it is absolutely correct that the timing is very important; however, as you have heard the story, the J. & L. story and the Lykes-LTV story, that all happened only 20 months ago. Six months more could cost us those two facilities, and we could lose the viability of maintaining those two facilities that United States Steel no longer chooses to operate, but that someone else, including local ownership, would like to acquire. We must have EDA help and support instead of their just sending an individual to the area. We need performance to help the Mahoning Valley, beyond just setting aside $225 million in loan guarantees. If the United States Steel Corp. does not choose to sell it, there is nothing we can do. EDA can, and should, and must, play an important role in this activity.

Mr. **Tauke**. Mr. Chairman, if the subcommittee is going to get into this, it would occur to me that it would also be appropriate to talk to someone from United States Steel, because if United States Steel is preventing the sale of any of these facilities to a competitor, that, it seems to me, does reflect very significantly on the antitrust and restraint of trade aspect of our work.

Mr. **Williams**. I will send you, Mr. Chairman, a copy of the public statement Mr. Roderick made last evening. [See Appendix J.]

Mr. **Rosenberg**. Mr. Chairman, might I make a suggestion? I think it might be in order for us to make an effort to contact the Senate Small Business Committee and perhaps coordinate with the hearings they are anticipating and that they have already planned in this area.

Mr. **Bedell**. I think that is excellent advice, and if we can cooperate in that manner to try to inject that.[1]

Mr. **Rosenberg**. There has been information brought out here today that we could make available to them that would be helpful and perhaps their already scheduled hearings could take a more direct course as a result.

Mr. **Bedell**. Would you also work with Mr. Williams?

Mr. **Rosenberg**. Very definitely.

Mr. **Bedell**. The purpose of these hearings is to look at how these mergers affect local communities. There had also been efforts to try to determine what they do to competition, which we have gotten into here a little bit.

---

[1] Committee Note: Chairman Bedell addressed the Senate Select Committee on Small Business on February 5, 1980. His prepared remarks appear in Appendix K.

If there is a problem within local communities, what is it that we can do about it?

From your testimony it is pretty clear that there has been a serious problem in your community.

Reverend Rawlings. Yes.

Mr. Bedell. Have you seen a difference in the unemployment rate, as a result of this, in the community? Is there any economic documentation? You can't lose that many jobs without problems.

Reverend Rawlings. There is a recent study just completed by the Federal Reserve Bank, which takes a look at the impact of the first round of shutdowns in 1977-78 on the employment situation in Youngstown. What you see is something like a third of the workers forced into early retirement. A figure of somewhere around 20 to 25 percent of them were forced to leave the community. Some of the most highly skilled get well placed in other industries. A very substantial number end up in menial labor jobs; they move from $10 and $11 an hour down to $4 and $5 an hour.

Mr. Bedell. Is there any indication of the number of other jobs that are lost in the small business community when a plant closes, or is that not particularly documented?

Mr. Kelly. Mr. Chairman, at the time when the Campbell Works, the first closing took place, there was a computer projection done at Ohio State, I believe, that projected that in the long run the overall number of other jobs in the community that would be lost because of the 5,000 loss at the steel mill, would be 13,000 other jobs.

That was a prediction. It may not be that all that has happened. I don't know the specific numbers, but I think it is clear that many smaller fabricators, and other businesses in the community, including retail establishments, have been affected.

I don't have specific documentation as to numbers.

Reverend Rawlings. It is a hazy area because these things unfold over time, and it is hard to track them; it is hard to find the data; and our labor statistics data gathering really doesn't monitor a lot of this as accurately as you might hope.

But just think of this: We are talking about two major steel mills closed and two more to close within the present 6-month period; 10,000 basic steel jobs lost, and then you have to add to that all the truck drivers who brought the steel in, and the raw materials, and took the steel out. You are talking about the railroading operations that were attached to that, a vast area of job loss in the valley.

Mr. Bedell. In some of your statements you said you had documentation of those items, such as some of the letters you received from EDA. I presume you will make those available to the staff of the subcommittee. I think it is fairly important that we have those if we pursue this further either by ourselves or with the Senate.

Reverend Rawlings. We will make all that available to you, sir.

Mr. Bedell. Thank you very much.

Mr. Kelly. Mr. Chairman, I have three reports I had done I would like to submit as supplements to my testimony, also.

[These reports and a further discussion of these events can be found in Mergers and Industrial Concentration, hearings before the

best copy available

Subcommittee on Antitrust and Monopoly of the Committee of the Judiciary, U.S. Senate, May 12, 1978.]

Mr. **Bedell**. Thank you all very much for your testimony.[1]

The subcommittee is adjourned.

[Whereupon, at 11:45 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

---

[1] Committee Note: For further insight into the effects of the Youngstown Sheet and Tube merger, history on the workers and community of Youngstown, and the attempt at employee ownership in Youngstown, see the transcripts of MacNeil/Lehrer Reports No. 3173 and No. 3231 in Appendix L.

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

THURSDAY, FEBRUARY 7, 1980

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,

Washington, D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2359-A, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

Mr. BEDELL. The subcommittee will come to order. First of all, I think an apology is in order from your chairman. The national prayer breakfast was this morning. It was clear out at the Washington Hilton Hotel. We just got back, and I ran over here as fast as I could. I want to thank the witnesses for being here this morning.

OPENING STATEMENT OF CHAIRMAN BEDELL

The Subcommittee on Antitrust is in the midst of a series of hearings on conglomerate mergers and their effects on small businesses and local communities. This week we are scheduled to hear from witnesses representing a wide range of Government agencies that become involved in conglomerate acquisitions or divestitures.

Today we will hear from the Justice Department and the Federal Trade Commission, the two Federal agencies charged with responsibility for reviewing mergers before they occur. We are pleased to have with us the Nation's top antitrust officials.

In my opinion, antitrust enforcement is perhaps the single most important role the Government has to play in our economy. I am a strong believer in our free enterprise, competitive market system. But as a small businessman myself, I know how necessary it is for the Government to assure that all are competing fairly and equitably. With healthy competition and effective, rigorous, antitrust enforcement the market should regulate itself more efficiently than can ever be done by the Government. However, there is some concern that corporate decisionmakers sometimes fail to take into account the social consequences of business decisions, and that is a point we are here to explore.

At our hearings last week we heard testimony about several merger cases in which either the Justice Department or the Federal Trade Commission played an important role. Specifically, I have in mind the Lykes-Youngstown merger and the American Safety Razor Co. divestiture by Philip Morris. While I expect most of our discussion today will tend more to the philosophical, I do think we will want to use those cases as specific examples in the course of conversation.

To those who have been following our hearings, I would like to make two brief comments. First, following up on our hearing last Friday, we have joined with the Senate Select Committee on Small Business to undertake a joint pursuit of the steel plant closings issue. On Tuesday, February 5, I participated in a hearing on that subject, chaired by Senator Stewart of Alabama.

Second, Robert Hall, the head of the Economic Development Administration, has agreed to testify in person. This had been a matter of some discussion previously. Mr. Hall will appear before us on Wednesday, February 27.

Now, I wish to introduce today's witnesses. They each have prepared statements which I encourage them to summarize. We have seated them as a panel so that we can have an open discussion about an issue that overlaps the jurisdictions of both their agencies.

Harold Williams, who is the chairman of the Securities and Exchange Commission, had been scheduled to testify as a witness at today's hearings. However, he had to attend a funeral in Chicago yesterday and therefore is unable to be here this morning. We are attempting to reschedule him for a later hearing of this committee.

Sanford Litvack is the recently appointed head of the Justice Department's Antitrust Division. He is variously referred to as either the Special Assistant to the Attorney General or as the Assistant Attorney General. I hope that he will help us clear up exactly what his proper title should be. While Mr. Litvack is a relative newcomer at the Justice Department, he is fast becoming a well-known figure here at the Small Business Committee.

Our other witness, Alfred Dougherty, is the Director of the Bureau of Competition at the Federal Trade Commission. I have told Al that he heads the half of the agency that I believe is the important part of that total agency. He is accompanied by Kenneth Davidson, Deputy Assistant Director of the Bureau.

PANEL CONSISTING OF FEDERAL ANTITRUST ENFORCEMENT OFFICIALS: ALFRED DOUGHERTY, JR., AND SANFORD LITVACK

Mr. BEDELL. As is our custom, I would like you gentlemen to stand and raise your right hands in order that I might swear you in.

In the testimony that you offer this committee today, do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. LITVACK. I do.

Mr. DOUGHERTY. I do.

Mr. DAVIDSON. I do.

Mr. BEDELL. I think we will start with you, Mr. Litvack, if that is agreeable. You may either summarize your statement or read it as you see fit.

Mr. LITVACK. With your permission, Mr. Chairman, I will just read portions of it which I think capture the essence of it.

Mr. **Bedell**. You have more than my permission; you have my congratulations.

TESTIMONY OF SANFORD M. LITVACK, SPECIAL ASSISTANT TO THE ATTORNEY GENERAL, DEPARTMENT OF JUSTICE

Mr. **Litvack**. At the outset I ought to respond to your invitation to clarify my own status. Happily you asked what my title should be rather than what it is. I suppose my title should be Assistant Attorney General in charge of the Antitrust Division but, as you know, Mr. Chairman, I still carry the title of the Special Assistant to the Attorney General because John Shenefield still is Assistant Attorney General in charge of the Division and has been acting as Associate Attorney General. He has not yet been confirmed as Associate Attorney General. We all hope that will happen shortly and as soon as that transpires, I, having been confirmed by the Senate already, would probably then be sworn in by the Attorney General shortly thereafter.

Mr. Chairman, I am pleased to have the opportunity to appear before this subcommittee today to discuss the possible effects that conglomerate mergers can have on the members of the small business community and to analyze the ability under existing antitrust laws to deal with the potential harms.

As the interest of this subcommittee indicates, small business' concern about conglomerate mergers is a significant one. But the small business community's concern is also part of a broader public debate concerning the social, political, and economic significance of the conglomerate merger movement and the appropriate role of the antitrust laws in dealing with problems that these mergers may create.

The administration is aware of the debate about the merits of conglomerate mergers, but has not reached a final decision on the issue. The Antitrust Division, however, has for its part weighted the positive and negative effects of conglomerate mergers, and is of the view that, on balance, the current phenomenon is contrary to the public interest. Among other reasons, we share this subcommittee's concern that conglomerate mergers may jeopardize the important role small business plays in our economy.

An important goal of antitrust enforcement is to protect and preserve the crucial role traditionally played by small business in the American economy. While it is true that the antitrust laws protect competition, not just competitors, and further that they should be applied evenhandedly to all regardless of size, any competitive restraints in fact impact particularly hard on smaller firms. Thus, effective antitrust enforcement is crucial to their well-being. Small business is itself important to the competitive process. Small firms have often been innovators in bringing about significant technological advances and introducing ingenious marketing plans. Few industries have not been strengthened by the contributions of small, energetic firms. A strong small business community also fits well with our traditional social and political values of diversity and broad dispersion of economic power.

Thus, to the extent that conglomerate mergers may significantly undercut the important role that small business has played, they raise concerns worthy of serious attention and response.

The extent to which conglomerate mergers are likely to have actual adverse effects on small businesses and local communities is, as I have indicated, a matter of substantial debate.

The Antitrust Division does not believe that severe adverse effects on small businesses or local communities will necessarily attend every conglomerate merger. Nonetheless, given the large number of such mergers, and the importance of small business and individual entrepreneurship in the American economy, we think that the possibility of such effects should be part of the overall consideration of the conglomerate merger program.

In its report of June 30, 1979, on conglomerate mergers, small business, and the scope of existing antimerger statutes, the Department outlined particular effects that conglomerate mergers may have on small business. I will not repeat them here. Suffice it to say, that the potential adverse effects of conglomerate mergers on small business and local communities may be direct and indirect reaching competitors, customers, suppliers, service firms, and the local community as a whole. Whether such effects will actually occur, or will be outweighed by possible benefits to other firms or the competitive process generally, is impossible to state as a general rule. But they must be recognized as part of the overall conglomerate merger problem.

Some adverse effects of conglomerate mergers on small businesses and local communities can be partially addressed through the enforcement of laws aimed at promoting competition. To a limited extent, this is done today under theories the courts have accepted in conglomerate merger cases. Other effects, however, do not form the basis for challenge under current law which is primarily intended to protect competition.

The Antitrust Division has sought to limit concentration and preserve opportunities for small business through aggressive enforcement of the existing law. We will continue to do that. Unfortunately, the specific provisions of Section 7 have been interpreted in ways that severely limit their application to conglomerate mergers. In many cases, potential adverse effects on small business, including competitive effects, cannot be established with sufficient particularity or to the requisite degree of probability to constitute proof of specific anticompetitive effects in particular markets. Although the courts have accepted several theories under the conglomerate merger law, in practice the burden of proof has been such that they are often difficult to satisfy.

The Section 7 theory that deals most directly with the adverse effects of conglomerate mergers on small business is the entrenchment theory. This concept is based on the possibility that the acquiring firm will be able to transfer its economic power to bolster the position of the acquired firm. However, the fact is that the theory will not always carry the day in all situations because of the courts having grafted limitations upon it. For example, the courts have refused to apply the theory where the acquired firm did not already hold a dominant position in a concentrated industry. Similarly, the courts have not applied it where there was not a complementary relationship between the two companies.

I think it is fair to say that under current law proof of unlawful entrenchment could not be made out in many cases in which small business may see their efforts effectively chilled by the overwhelming presence of a large conglomerate.

Another theory which the courts have accepted as a concept is reciprocity. this theory, like entrenchment, focuses on economic power; that is, substantial buying power of the acquiring firm.

A greater opportunity for reciprocal dealing, however, is unlikely as a practical matter in and of itself to be sufficient to enjoin a merger. Courts are apt to look for and have looked for additional evidence of a sufficient likelihood of substantial anticompetitive effects in a particular market. Thus, that theory, too, has been practically limited.

While less directly related to specific adverse effect of conglomerate mergers on small business, another theory used to challenge conglomerate mergers is the potential competition theory, which focuses on the probability for significantly increased competition if the merger is proscribed rather than on possible transfer of the conglomerate's economic power. Such a case may involve proof of actual potential entry or perceived potential entry, or both.

When we talk about actual potential competition, we are focusing on the possibility of an alternate de novo or toehold entry by an acquiring firm. Perceived potential competition, on the other hand, focuses on the current procompetitive effects that a powerful potential competitor may have on the market as a result of its position in the wings. Again, as the case law has developed, the problems of proving either can, in fact, be quite difficult.

I should note that while we have been talking about conglomerate merger theories, it should also be noted that conglomerate mergers may have horizontal or vertical aspects to them which can be challenged under existing Section 7 theories. For example, one of the possible injuries to a small business, customers or suppliers, is that the acquired firm may satisfy all of its sale or purchase requirements through transactions with the conglomerate itself.

A merger with such vertical foreclosure effects could be challenged if the foreclosure exceeded established vertical merger standards. However, in truth, mergers with challengeable vertical foreclosure effects are few and far between. Thus, it is possible that a merger with a vertical effect that forecloses some opportunity for some small business, and impose at least transition costs related to disruptions of sales or supply, could not meet the standard for successful challenge.

The bottom line on the extent to which current antitrust laws cover conglomerate mergers generally and the effects on small businesses and local communities particularly, is easy to state. However, it is hard to measure. Antitrust law focuses almost entirely on predictable effects on competition—on the health and vitality of the competitive process. Where threats to that process coincide with the risks that small businesses and local communities may face from a particular merger, the antitrust laws can be effective. In view of the fundamental social, political, and economic bases of the antitrust laws, local interests, and possible effects on small business can be influential in deciding whether to prosecute close cases. But when it comes right down to what is legal and what is not, to win a merger case you have to prove the probability of a substantial lessening of competition in carefully defined product and geographic markets. Dislocation and possible hardships will not themselves carry the day.

To summarize, the Antitrust Division is concerned about the trend toward increased concentration of which conglomerate mergers are a part.

We recognize that the problem is extremely complex and that the antitrust laws, which focus on competition, cannot be viewed as the only solution. A combination of approaches to ameliorate possible adverse effects of dislocations, and yet preserve some benefits that can derive from particular mergers, should be considered. One part of the solution may be new legislation to prohibit certain conglomerate mergers that do not substantially enhance competition.

The acquisitions affected by this proposal, which we have endorsed, are, in our view, unlikely to lead to greater efficiencies inasmuch as the firms involved are usually large enough to have already achieved economies. Where the firms involved, however, can meet the burden of demonstrating that the acquisition will have substantial procompetitive effects, we believe that the public interest can be served by permitting the acquisition.

In short, we believe that many of the adverse effects of conglomerate mergers can be addressed by a limited, clearly defined proscription on acquisitions that do not demonstrably promote competition.

I hope my remarks will be useful to the subcommittee in its investigation of the effects of conglomerate mergers. I would, of course, be happy to attempt to answer any questions that the subcommittee may have.

Thank you, Mr. Chairman.

[Mr. Litvack's prepared statement follows:]

Prepared Statement of Sanford M. Litvack, Special Assistant to the Attorney General, Department of Justice

Mr. Chairman and Members of the Subcommittee; I am pleased to have the opportunity to appear before this Subcommittee to discuss the possible effects that conglomerate mergers can have on the members of the small business community and to analyze the ability under existing antitrust laws to deal with potential harms.

As the interest of this Subcommittee indicates, small business' concern about conglomerate mergers is a significant one. But the small business community's concern is also part of a broader public debate concerning the social, political, and economic significance of the conglomerate merger movement and the appropriate role of the antitrust laws in dealing with problems that these mergers may create.

Those concerned about the recent wave of conglomerate mergers, the Antitrust Division among them, have noted that conglomerate mergers may contribute to needless concentration of economic and political power in the hands of a relatively small number of major corporations, removing independent voices from the business community. In addition, such mergers, particularly the largest of them, may separately or cumulatively pose substantial dangers to fair and effective competition, particularly in the long run. For example, conglomerate transactions may channel corporate funds and energies away from more procompetitive strategies of growth such as new entry and "toehold" acquisitions in concentrated industries.

Conglomerate mergers of course have their proponents, who argue that they enhance corporate efficiency through maximization of the effective use of resources, permitting the transfer of assets to firms more able to manage them successfully. Such mergers are also alleged to facilitate "synergy" which occurs when the firms are able to operate more effectively together than apart; to facilitate the raising and movement of capital; to provide opportunities to shareholders to sell businesses at fair value; and to promote efficiency in management through takeovers or threats of takeovers.

The Administration is aware of the debate about the merits of conglomerate mergers, but has not reached a final decision on the issue. The Antitrust Division, however, has for its part weighed the positive and negative effects of conglomerate mergers, and is of the view that, on balance, the current phenomenon is contrary to the public interest. Among other reasons, we share this Subcommittee's concern—that conglomerate mergers may jeopardize the important role small business plays in our economy.

An important goal of antitrust enforcement is to protect and preserve the crucial role traditionally played by small business in the American economy. While it is true that the antitrust laws protect competition rather than competitors, and should be applied even-handedly to all regardless of size, many competitive restraints impact particularly hard on smaller firms. Thus, effective antitrust enforcement is crucial to their well-being. Small business is itself important to the competitive process. Small firms have often been innovators, bringing about significant technological advances and introducing ingenious marketing plans. Few industries have not been strengthened by the contributions of small, energetic firms. A strong small business community also fits well with our traditional social and political values of diversity and broad dispersion of economic power. Thus, to the extent that conglomerate mergers may significantly undercut the important role that small business has played in our economy, and must continue to play, they raise concerns worthy of serious attention and response.

ADVERSE EFFECTS OF CONGLOMERATE MERGERS ON SMALL BUSINESS

The extent to which conglomerate mergers are likely to have actual adverse effects on small businesses and local communities is a matter of substantial debate. Some argue that such effects are almost the necessary and probable result of nearly all large mergers; others conclude that they are rare, and in any event are likely to be outweighed by gains in efficiency or other benefits to the local economy. Obviously, the truth lies somewhere between. The Antitrust Division does not believe that severe adverse effects on small businesses or local communities will necessarily attend every conglomerate merger. Nonetheless, given the large number of such mergers, and the importance of small business and individual entrepreneurship in the American economy, we think that the possibility of such effects should be part of the overall consideration of the conglomerate merger problem.

In its report of June 20, 1979 on conglomerate mergers, small business, and the scope of existing antimerger statutes, the Department outlined particular effects that conglomerate mergers may have on small business. I will not repeat in detail the contents of that report, but it might be useful briefly to summarize it.

First, conglomerate mergers may place small firms which must continue to compete against a firm acquired by a conglomerate at a competitive disadvantage. After a merger, the acquired firm may have resources at its disposal that could permit it to engage in practices aimed at chilling competition and achieving a dominant market position. When the acquired firm already approaches such dominance, particularly in a concentrated industry, the possibility of such effects is increased. In antitrust parlance, these effects are commonly referred to as "entrenchment."

Second, conglomerate mergers may place severe pressures on small firms that are not competitors of the acquired firm. Firms that purchase from or sell to the acquired firm may be directly affected by a conglomerate acquisition; other small firms in the acquired firm's local community may also be affected indirectly by the amalgamation.

Third, the difficulties that may be experienced by small competitors, purchasers, and suppliers of a firm acquired in a conglomerate merger may cumulatively impact on the local community in which the acquired firm is located. A variety of small manufacturers, wholesalers, retailers, and service firms could be directly prejudiced, with consequent indirect effects on an even broader range of small businesses and citizens within the community.

In sum, the potential adverse effects of conglomerate mergers on small business and local communities may be direct and indirect, reaching competitors, customers, suppliers, service firms, and the local community as a whole. Whether such effects will actually occur, or will be outweighed by possible benefits to other firms or the competitive process generally, is impossible to state as a general rule. But they must be recognized as part of the overall conglomerate merger problem.

CHALLENGE TO CONGLOMERATE MERGERS UNDER EXISTING LAW

Some adverse effects of conglomerate mergers on small businesses and local communities can be partially addressed through the enforcement of laws aimed at promoting competition. To a limited extent, this is done today under theories the courts have accepted in conglomerate merger cases. Other effects, however, do not form the basis for challenge under current laws primarily intended to protect competition.

Section 7 of the Clayton Act, the major antitrust merger law, prohibits an acquisition "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." In passing the Celler-Kefauver Act in 1950, which, among other things, extended section 7 to cover asset as well as stock acquisitions, Congress was seriously concerned about the economic effects of increased concentration. Further concern was expressed that concentrated economic power might lead to demand for increased governmental control of giant firms, and that absentee ownership by large corporations might diminish local initiative and civic responsibility. The importance of dispersed economic power and diversity in our economy, including preservation of a key role for small business and individual entrepreneurship, was hence a significant part of the rationale for the last real strengthening of our antimerger laws.

The Antitrust Division has sought to limit concentration and preserve opportunities for small business through aggressive enforcement of the existing law. We shall continue to do so. Unfortunately, the specific provisions of section 7 have been interpreted in ways that severely limit their application to conglomerate mergers. In many cases, potential adverse effects on small business, including competitive effects, cannot be established with sufficient particularity or to the requisite degree of probability to constitute proof of specific anticompetitive effects in particular markets. Although the courts have accepted several theories under which conglomerate mergers may be challenged, in practice the burden of proof under those theories has been very difficult to meet.

The Section 7 theory that deals most directly with adverse effects of conglomerate mergers on small businesses is the entrenchment theory. This concept is based on the possibility that the acquiring firm will be able to transfer its economic power to bolster the position of the acquired firm. However, the theory will not necessarily carry the day in all situations in which other firms, including small businesses, may be threatened in some way by an entrenching transfer of power.

Courts sometimes have required proof of certain specific market conditions before finding that a transfer of power is likely to result in a substantial lessening of competition. For example, they have refused to apply the theory where the acquired firm did not already hold a dominant position in a concentrated market.[1] While the entrenchment effect may be more likely in such situations, it is certainly possible in others as well, perhaps to a degree that would not prevent competition by other large and powerful rivals, but that would pose serious obstacles to smaller competitors with limited resources.

It has also been held that an unlawful entrenching effect may depend in large part upon a close complementary relationship between the products of the acquiring and the acquired firms.[2] A transfer of economic power may be more conveniently made in such circumstances, but a conglomerate's resources may also be employed to the detriment of small competitors when the acquiring and acquired firms' products are totally unrelated.

Of course, all of the necessary conditions will be met in some cases.[3] When they are, the entrenchment theory can be effective to prohibit conglomerate mergers that may injure small business. However, I think it fair to say that under current law, proof of unlawful entrenchment could not be made out in many cases in which small businesses may see their efforts effectively chilled by the overwhelming presence of a large conglomerate.

Another theory which the courts have accepted in challenges to conglomerate mergers is the "reciprocity" theory.[4] This theory, like the entrenchment concept, focuses on the economic power—substantial buying power in particular—of the acquiring firm. When that firm has substantial power in a specific market or markets, it may be able to use that power as leverage to enhance the market position of the acquired form. The conglomerate may condition its orders on a supplier's continued or future purchases of the acquired firm's products. The ability to exert this kind of leverage explicitly or tacitly could, of course, put smaller, undiversified firms at a competitive disadvantage.

A greater opportunity for reciprocal dealing, however, is unlikely in and of itself to be sufficient to enjoin a merger. Courts are apt to look for additional evidence of a sufficent likelihood of substantial anticompetitive effects in particular markets.[5] The *Consolidated Foods* case, while citing signficantly increased opportunities for reciprocity, also relied heavily on evidence that reciprocal practices had been used to maintain the acquired firm's already substantial market share. Thus, a conglomerate merger that increases the opportunities for reciprocity may discourage aggressive competition from small firms without similar leverage but remain within the law because of a lack of clear proof that those opportunities will be exercised.

---

[1] See *Butler Aviation Co. v. CAB*, 389 F. 2d 517, 519–21 (2d Cir. 1968).

[2] See *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 773–76 (D.Md. 1976).

[3] See, *e.g.*, *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

[4] See *FTC v. Consolidated Foods*, 380 U.S. 592, 594 (1965).

While less directly related to specific adverse effects of conglomerate mergers on small business, another theory often used to challenge such mergers is the potential competition theory, which focuses on probabilities for significantly increased competition if the merger is proscribed rather than on possible transfer of the conglomerate's economic power. A potential competition case may involve proof of actual potential entry by the acquiring firm, perceived potential entry, or both. Actual potential competition focuses on the possibilities of alternate de novo or "toehold" entry by an acquiring firm, with likely procompetitive results. Perceived potential competition focuses on the current procompetitive effects that a powerful potential competitor may be having on a market from its position "in the wings." As the case law has developed, however, the problems of proving either can be quite difficult.

The potential competition theory is usable primarily when the acquired firm has a substantial market share in a concentrated industry and the acquiring firm is one of a limited number of potential entrants.[6] Otherwise, the loss of the acquiring firm as an independent entrant or as a procompetitive influence on the fringe of the market is not viewed as sufficiently likely substantially to lessen competition within the meaning of section 7. Given the present trend toward diversification, a variety of firms could be considered potential entrants into many industries solely because of their financial resources. Thus, while the theory may remain useful for geographic- and product-extension mergers where potential entrants can be identified on the basis of particular characteristics,[7] it is of limited value in challenging pure conglomerate acquisitions.

The perceived potential competition theory also may require actual proof that market participants' perceptions that the acquiring firm was a likely entrant caused them to refrain from anticompetitive practices.[8] Empirical cause and effect evidence involving a determination of how the market would have worked in the absence of the perceived potential entrant may be difficult to obtain.

The actual potential competition theory has its own evidentiary difficulties. In such cases, we would argue the sufficiency of objective evidence indicating that the acquiring firm was a likely entrant through internal expansion or a toehold acquisition. However, courts may require some subjective evidence demonstrating that the acquiring firm intended to enter by such other means were it not for the merger agreement.[9] That type of evidence as to a firm's intentions, particularly when acquisition opportunities are still open, may be extremely hard to come by. Such evidentiary difficulties limit the opportunities for successful challenge of conglomerate mergers under a potential competition theory.

While we have been discussing so-called "conglomerate merger" theories, it should also be noted that some primarily conglomerate mergers may have horizontal or vertical aspects that can be challenged under more traditional merger theories. For example, one of the possible injuries to small business customers or suppliers is that the acquired firm might satisfy all of its sale or purchase requirements through transactions with the conglomerate itself. A merger with such vertical foreclosure effects could be challenged if the foreclosure exceeded established vertical merger standards. These standards require that the merger result in a "substantial" foreclosure in either a purchase or supply market. In other words, the acquiring and acquired firms must account for significant shares of the purchases and sales in the particular market under consideration. Effects on entry barriers and trends toward vertical integration are also important factors. However, mergers with challengeable vertical foreclosure effects are few and far between. Thus, it is possible that a merger with vertical effects that foreclose opportunities for some small businesses, and impose at least transition costs related to disruptions of sales or supply, could not meet the standards for successful challenge. Moreover, it is important to note that even a successful challenge to a conglomerate merger may result only in a partial divestiture or other relief designed to cure the particular anticompetitive effects identified. In other words, despite its other possible adverse effects, none of which meets the probability standards of section 7, such a merger may be allowed to proceed, conditioned on less than complete relief.

---

[5] See Liebeler, "The Emperor's New Clothes—Why is Reciprocity Anticompetitive?" 44 St. John's L. Rev. 545 (spec. ed. 1970).

[6] See *United States* v. *Marine Bancorporation Inc.*, 418 U.S. 602, 623-25 (1974); *FTC* v. *Procter & Gamble Co.*, supra at 581. See also Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," 78 Harv. L. Rev. 1313 (1965).

[7] See, e.g., *United States* v. *Falstaff Brewing Corp.*, 410 U.S. 526, 553–54 (1974); *FTC* v. *Procter & Gamble Co.*, supra.

[8] See *United States* v. *Marine Bancorporation Inc.*, supra, at 624–25.

[9] See *FTC* v. *Atlantic Richfield Co.*, 549 F. 2d 289, 296–97 (4th Cir. 1977); *United States* v. *Falstaff Brewing Corp.*, supra at 532–36, 563–70.

The extent to which current antitrust laws cover conglomerate mergers generally and the effects on small businesses and local communities particularly, is easy to state, if hard to measure. Antitrust law focuses almost entirely on predictable effects on competition—on the health and vitality of the competitive process. Where threats to that process coincide with the risks that small businesses and local communities may face from a particular merger, the antitrust laws can be effective. In view of the fundamental social, political, and economic bases of the antitrust laws, local interests and possible effects on small business can be influential in deciding whether to prosecute close cases. But when it comes right down to what is legal and what is not, to win a merger case you have to prove the probability of a substantial lessening of competition in carefully defined produce and geographic markets. Dislocation and possible hardships will not themselves carry the day.

To summarize, conglomerate mergers present a number of adverse social, political, and economic effects. Their competitive effects are partially, but probably not in the long run completely, addressed by existing antitrust law. Some conglomerate mergers—certainly not all, but some—probably have unfortunate and unbalanced adverse effects on small businesses and local communities. Smaller firms may suffer because of an inability to compete with a conglomerate, because their customers or sources of supply are withdrawn, or because the well-being of the community in which they operate becomes the victim of indifference, sacrificed for broad corporate goals.

The Antitrust Division is concerned about the trend toward increased concentration of which conglomerate mergers are a part, the social, political, and economic problems they may engender, and the limited usefulness of existing law. We recognize, however, that the problem is extremely complex, and that the antitrust laws, which focus on competition, cannot be viewed as the only solution. A combination of approaches to ameliorate possible adverse effects or dislocations, and yet preserve some benefits that can derive from particular mergers, should be considered. One part of the solution may be new legislation to prohibit certain conglomerate mergers that do not substantially enhance competition. The legislative proposal we have endorsed focuses on acquisitions that combine very large firms and acquisitions by large firms of leading firms in concentrated markets. We believe that these kinds of mergers, involving large and dominant firms, pose the greatest threat of economic and social injury with the least probability of public benefit.

The acquisitions affected by this proposal are unlikely to lead to greater efficiencies, since the firms involved are usually large enough to have already achieved economies. Where the firms involved, however, can meet the burden of demonstrating that the acquisition will have substantial procompetitive effects, we believe that the public interest can be served by permitting the acquisition. We recognize that mergers sometimes play an important role in transferring capital, technology and know-how to achieve more efficient resource allocation. Therefore, we would create a rebuttable presumption that the acquisition will not provide public benefits, rather than a complete ban. We believe that many of the adverse effects of conglomerated mergers can be addressed by a limited, clearly-defined proscription on acquisitions that do not demonstrably promote competition.

I hope my remarks will be useful to the Subcommittee in its investigation of the effects of conglomerate mergers. I would be glad to try to answer any questions that the Subcommittee may have.

Mr. BEDELL. Thank you very much, Mr. Litvack.

I believe we will hear from Mr. Dougherty first, before we proceed with our discussion.

We are glad to have you here, Mr. Dougherty.

TESTIMONY OF ALFRED F. DOUGHERTY, JR., DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION; ACCOMPANIED BY KENNETH M. DAVIDSON, DEPUTY ASSISTANT DIRECTOR

Mr. DOUGHERTY. Thank you, Mr. Chairman.

I appreciate the opportunity to discuss some of the current thinking at the Bureau of Competition on the subject of conglomerate mergers and their potential effects on small business and the local community.

My remarks represent my own views as a member of the staff of the Federal Trade Commission, and they do not necessarily represent the views of the Commission or any individual Commissioner.

I have with me today, as you mentioned earlier, Mr. Kenneth Davidson. He is a Deputy Assistant Director in the Bureau of Competition. He was the staff member in charge of our conglomerate merger project when we were working with the Antitrust Division and with the Senate Judiciary Committee in trying to develop various proposals that could be introduced.

The Bureau of Competition is that part of the Federal Trade Commission which is charged with maintaining our Nation's competitive economic system through the vigorous enforcement of the antitrust laws.

Much of our antitrust effort is directed toward the investigation of mergers and their possible effects on competition. In this endeavor, we take as our basic text Section 7 of the Clayton Act. While much of our enforcement efforts are directed at individual cases in particular industries, the Bureau of Competition has a larger mission in maintaining competition throughout those sections of the economy where the Federal Trade Commission has jurisdiction. Thus, we review those sectors of the economy looking for trends which suggest problems in the competitive marketplace. I would like to focus on two trends which are troubling us today.

First, I believe it is clear that the American economy is in the midst of a continuing merger wave. We saw a dramatic shift in merger activity between 1977 and 1978. Significantly, the number of larger mergers was substantially on the increase. Eighty of the acquisitions announced in 1978 were of firms valued at $100 million or more, almost double the 41 $100 million mergers announced in 1977.

Figures for 1979 are now available. In 1979, 83 announced acquisitions were of firms valued at $100 million or more. Moreover, the total value of 1979 mergers was $43.5 billion—a new 10-year high. That figure represents a significant increase of 27 percent over 1978. That even beats the inflationary increase.

A second trend we recognize indicates what may already be clear to members of this subcommittee: Small business appears to be in greater trouble today than ever before. By many economic indicia, small business is enjoying a decreasing share of the economic pie.

Trouble for the small businessman is a source for concern about the health of our entire economy because small business is the most important single source of innovations and new jobs in the economy.

I wish I could simply equate the problems faced by small business with the current merger wave. Then, perhaps, we could simply focus on the current proposals that have been presented for preventing conglomerate mergers and presume that the small businessman's problems would disappear if we were successful. But we are hardly faced with so simple a set of circumstances. It appears to me that some conglomerate mergers probably do have adverse impacts on small business and local communities directly affected by them. But other mergers may have beneficial effects on small business and local communities while still others may have not much effect at all. Similarly, some conglomerate mergers are unlawful under the antitrust laws while others are not.

The subject of plant closings raises the specter of the most serious harm that can come to small businessmen and the local community. Let us assume, first, that the acquired business in the example I have used in my prepared testimony was facing a precarious financial situation and was on the verge of bankruptcy. There was no more than a dim prospect that the firm might survive bankruptcy or some other form of corporate reorganization as a going concern. It would probably be faced with liquidation. Moreover, the owners of the business had made a thorough and exhaustive search of local prospective purchasers. The only one they could find at any price was the acquiring company. Finally, let us assume that antitrust analysis, focusing on the industry in which the acquisition took place, disclosed that the acquisition was likely to be unlawful under Section 7 of the Clayton Act because it substantially lessens competition.

If the acquired company is on the verge of bankruptcy, is unlikely to survive reorganization and can find no alternative purchasers, it qualifies as a "failing company" under existing antitrust laws, and its otherwise anticompetitive acquisition will be excused. The failing company defense to an otherwise illegal acquisition under Section 7 explicitly recognizes the harms that can come to local communities and small business from business failure, and balances those harms against the loss to the economy and society occasioned by a substantial lessening of competition.

The failing company defense then is explicit recognition that, at some point, the loss occasioned by a substantial lessening of competition attendant to a merger may be outweighed by the loss to a company's shareholders, its owners, and the local community that would result from its bankruptcy and liquidation.

The failing company defense is a rather narrow one with strict standards that must be met before it will be applied to excuse an otherwise anticompetitive merger. But its strict standards are consonant with the strong congressional policy, expressed in Section 7, of proscribing anticompetitive mergers. Only when an otherwise anticompetitive merger is company's last resort should it be excused.

What about a situation, however, which involves a potential plant closing but does not meet the strict requirements of the failing company defense?

In 1976, Philip Morris wanted to sell its ASR division to Bic, a French manufacturer of disposable razors. Gillette was the industry leader with 60 percent of the market, while Bic was second with 23 percent and ASR, under the Persona label, was third with 12 percent.

Although Philip Morris did not consider ASR to be in failing condition and although ASR had sales of $41 million, Philip Morris felt that ASR was not profitable enough to warrant retention. Philip Morris indicated to the FTC staff that if the sale to Bic were challenged, it would close ASR and lay off some 800 workers in a southern Virginia county with high unemployment. Our efforts to get Philip Morris to seek alternative purchasers were unsuccessful. After filing a request for an injunction in Federal district court, we negotiated with Bic and ASR, but the negotiations were unsuccessful. Philip Morris then announced that it would close the ASR plant in Virginia and that the loss of 800 jobs would be the Federal Trade Commission's fault.

The company did, in fact, lay off 250 workers immediately. We encountered a strong response from the ASR union and from some of Virginia's elected officials, but we continued to urge Philip Morris to seek alternative purchasers. Finally, Bic walked away from the deal and ASR's management purchased ASR from Philip Morris with the help of a loan guaranteed by the Commerce Department. While the ASR plant no longer manufactures Persona razors, it does manufacture and sell private label razors and blades.

Philip Morris did not have a valid failing company defense with respect to its ASR subsidiary. Its conglomerate parent had options other than closing the ASR division or selling it to a major competitor. But Philip Morris was not willing to devote the management time or supply the available capital necessary to rehabilitate or expand the division to a satisfactory profitability level or market share. Philip Morris had not made the diligent efforts required by the failing company defense to locate alternative purchasers for ASR. And ASR faced no immediate danger of liquidation. The only imminent danger ASR and its employees and community faced was the possibility of a self-interested corporate decision.

The eventual outcome of ASR was, I believe, a victory for antitrust policy for small businesses, and for local communities. Antitrust was served by maintaining competition in the safety razor business and the creation of a new and viable business entity. Small business gained a significant precedent because individuals who wish to acquire and operate divisions that do not meet conglomerate return on investment decisions will not have to bid against corporations whose willingness to pay a high price is based, in part, on the lessened competition resulting from the acquisition. Those with entrepreneurial spirit and resources will be able to bid fairly for the business venture. Finally, ASR demonstrates that communities are not helpless hostages to the decisions of distant corporations. Communities can gather their resources and, in cases like ASR, obtain loans from the Commerce Department.

Of course, employee or community ownership programs are not always ideally suited when a company decides to close its plants. If a company cannot operate a plant at a profit, or if an extensive modernization program is needed to make the plant efficient, costs and risks to employee groups or community groups may be too great.

Still, this alternative should not be overlooked. We now have the tax laws, for example, which encourage the creations of employee stock ownership plans, or ESOP's. ESOP's have been used successfully on a number of occasions to transfer ownership of plants and divisions to employees. I anticipate that ESOP's, along with other forms of employee ownership may become increasingly popular and a truly significant and obviously preferable alternative to anticompetitive mergers.

We should, however, look beyond solutions to the plant-closing dilemma and examine some of the root causes of mergers that affect small business. If other alternatives to merger are available, I believe many companies will take advantage of them. There is much that Government can do to encourage the development of these alternatives. Development of these alternatives could lead both to fewer conglomerate mergers and to fewer adverse consequences of the conglomerate ownership they create.

Sometimes, for example, the owners of companies, particularly small ones, believe they have no choice but to merge with a conglomerate or a large competitor. They may have exhausted their available capital and are unable to finance future expansion. Without the ability to grow independently, they face only the prospect of business decline unless they merge with a large firm. Thus the creation of great opportunities for small business to acquire capital should be an important priority for Government which can have the effect of lessening the urge to merge.

Some important first steps in this direction are underway. I support the efforts of the SEC, for example, which has recently adopted a number of rules which would lower substantially the cost of capital formation for small firms already regulated by the SEC. I also note the administration's recently proposed legislation which would permit small business to sell without SEC registration an unlimited amount of securities to large institutional and private investors, thus bypassing the entire regulatory system with its attendant costs of compliance.

Government regulation generally and its attendant compliance costs may be another factor limiting the small business' ability to grow on its own and contributing to the urge to merge. I support current efforts by the administration and Congress to conduct a comprehensive examination of the adverse effect of Government regulation on small business. Similarly, I welcome efforts to simplify and ease the regulatory burden placed on small business. The concept of two-tier regulation, which recognizes that a regulatory burden acceptable to large firms may put crushing pressure on their smaller rivals, has my support, bearing in mind, however, that in certain areas, such as health and safety regulation, the imposition of a uniform standard probably is appropriate.

Government tax policy may also be at the heart of some mergers that might not otherwise take place. For example, although some improvements recently have been made, capital gains taxation, while ostensibly a neutral tax policy, has had unfortunate consequences from a competitive perspective. Under the present Tax Code, small business owners wishing to sell their business are inclined to undertake tax-free stock swaps with large, blue-chip companies in order to avoid the capital gains tax attendant to sales of stock for cash. This tends to foreclose small businesses from acquiring other profitable small businesses, because small firms generally can offer the selling owners only cash or the acquiring company's securities, which may be less stable and hence less desirable than the securities of a large firm. This promotes the acquisition of successful small businesses by large firms, and relegates small firms to a position where they must grow by internal expansion or not at all. In the context of the capital disadvantages under which most small firms already operate, the inability of these firms to grow by acquisition widens the competitive gap between large and small firms. This is precisely the trend that should be reversed. I believe that amendments to the Tax Code according differential tax treatment to small and large firms should be explored as possible means by which to strenghten the small business sector, permit it to become more effective competitively, and provide alternatives to undesirable mergers.

Mr. Chairman, I have tried to stress in my remarks that concerns over the effects of conglomerate mergers and their effects on local communities and small businesses are best addressed by maintaining the strong antitrust policy of Section 7 of the Clayton Act, while considering new alternatives that might make mergers less desirable alternatives.

I have not tried to be comprehensive, but only suggestive of some of the ways I believe Government can act to make that happen. We at the Bureau of Competition are concerned with the effect of Government regulation and other Government policies on our work. And we are developing expertise in many of these areas, such as access to capital policies and tax policy, so that we might better advise you and others on how our competitive economic system—composed of many diverse businesses, small and large—can best be preserved.

Thank you again for the opportunity to express our views. Mr. Davidson and I will be happy to try and answer any questions you may have.

[Mr. Dougherty's prepared statement follows:]

PREPARED STATEMENT OF ALFRED F. DOUGHERTY, JR., DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

[These remarks represent only the views of a member of the Federal Trade Commission staff. They are not intended to be construed as representative of official Commission policy or the views of any individual commissioner.]

Mr. Chairman, I appreciate the opportunity to discuss some of the current thinking at the Bureau of Competition on the subject of conglomerate mergers and their potential effects on small business and the local community. My remarks represent my views as a member of the staff of the Federal Trade Commission. They do not necessarily represent the views of the Commission or any individual Commissioner.

The Bureau of Competition is that part of the Federal Trade Commission which is charged with maintaining our Nation's competitive economic system through the vigorous enforcement of the antitrust laws. We investigate possible antitrust violations throughout the American economy and, if the Commission has reason to believe that a particular antitrust violation is taking place, we prosecute the case against that violation before the Commission's Administrative Law Judges and the Commission itself.

Much of our antitrust enforcement effort is directed toward the investigation of mergers and their possible effects on competition. In this endeavor, we take as our basic text Section 7 of the Clayton Act, 15 U.S.C. § 18, which prohibits mergers and acquisitions among most corporations engaged in interstate commerce "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[1] Our statutory responsibility to enforce § 7 of the Clayton Act—a responsibility the FTC shares with the Department of Justice—leads us to review almost all significant mergers and acquisitions for their potential anticompetitive effects. For this purpose, we have a merger screening committee which meets weekly to review current merger activity in the economy, direct our staff to conduct preliminary investigations of questionable mergers, and consider staff proposals for further investigations of mergers which raise serious questions under Section 7.

---

[1] The FTC may also use section 5 of the FTC Act (15 U.S.C. 45) to prevent anticompetitive mergers and acquisitions. In addition to covering virtually all mergers and acquisitions subject to § 7 of the Clayton Act, section 5 of the FTC Act reaches mergers and acquisitions involving non-corporate entities and mergers and acquisitions involving entities which "affect" but are not "engaged in" interstate commerce. Section 5(a)(1) of the FTC Act states that "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."

Antitrust lawyers tend to classify mergers into three groups: horizontal, vertical, and conglomerate. And, I think it is fair to say that we have had different amounts of success—or the lack of it—in enforcing Section 7 in the context of each of these three types of mergers. We have had the greatest success in enforcing Section 7 against horizontal mergers, that is, mergers between two direct competitors in a particular industry which may substantially lessen competition in that industry through the elimination of a viable, independent competitor, while increasing the competitive strength of another. We have had some, although in my view less, success in enforcing Section 7 against vertical mergers, that is, mergers between a buyer and a seller in a distribution chain which may result in a substantial lessening of competition by market foreclosure. Other sellers in the market may be deprived of the opportunity to sell their goods to the buyer which has been captured by one of their competitors. If the acquired buyer is large enough, its loss as an independent outlet for other sellers' goods can mean a substantial lessening of competition among the sellers. Similarly, the competitors of the buyer may be foreclosed from access to the seller as a source of supply. If the seller is large enough, its loss can mean a substantial lessening of competition among remaining buyers. We have had the least success in trying to enforce Section 7 against conglomerate mergers, that is, mergers which involve neither direct competitors nor buyers and sellers. We are able, under present Section 7 law, to challenge some conglomerate mergers. It is clear that Congress meant Section 7 to apply to conglomerate mergers, as well as to horizontal and vertical ones, and there have been some enforcement successes. In instances, for example, where we can show that an acquisition has been made of an industry leader by a potential competitor in that industry—a firm which is likely to enter the industry on its own—and that industry would benefit from the injection of new competition, that it may be that the potential competitor's entry by acquisition rather than by internal expansion may substantially lessen competition in violation of Section 7. Or, when an acquisition gives a leading firm in a market new financial and marketing resources disproportionately larger than those of most or all of its remaining competitors, we may be able to show that the entrenchment of the acquired firm's market position may substantially lessen competition. But many conglomerate mergers remain beyond the reach of established Section 7 law.

The legal framework within which the Bureau of Competition examines all three types of mergers—Section 7 and legal precedents interpreting it—leads us to focus, in specific investigations, on the competitive effects of a particular merger within a particular industry. Some of the factors we examine include: (1) concentration in an industry or the market share held by the largest competitor and the combined market shares of the four or eight leading firms; (2) the presence or absence of a trend toward increasing concentration in that industry or whether the largest firms are increasing their joint market share over time; and (3) the state of barriers to entry into the industry or whether the industry is relatively easy or difficult to enter. Thus, if our review of a particular industry shows that it is highly concentrated and is becoming more so over time, and the industry is difficult to enter because entry barriers are high, then it is likely that the industry is not performing competitively and merger activity which might lead to even worse competitive conditions should be vigorously opposed.

I do not mean to suggest that I have given an exhaustive list of the factors we examine or that only when all of the listed factors come together do we challenge a particular merger. Each individual case is dependent upon its own facts. My intention has been to give you a flavor for our merger analysis process.

While much of our enforcement efforts are directed at individual cases in particular industries, the Bureau of Competition has a larger mission in maintaining competition throughout those sections of the economy where the FTC has jurisdiction. Thus, we review these sectors of the economy, looking for trends which suggest problems in the competitive marketplace. I would like to focus on two trends which are troubling us today.

First, I believe it is beyond cavil that the American economy is in the midst of a continuing merger wave. We saw a dramatic shift in merger activity between 1977 and 1978. In 1978, 2106 acquisitions were announced. The value of all publicly announced acquisitions in 1978 approached $34.2 billion, a 56 percent increase over the $22 billion value reported in 1977, and the highest dollar total of merger activity during the preceding ten years. Significantly, the number of larger mergers was substantially on the increase: Eighty of the acquisitions announced in 1978 were of firms valued at $100 million or more, almost double the 41 $100 million mergers announced in 1977.

Figures for 1979 are now available and they show that while 1979 did not see another dramatic rise in merger activity the pace set in 1978 continued unabated. Last year, 2128 acquisitions were announced, with a value of $43.5 billion—a new ten-year high. That figure represents a significant increase of 27 percent over 1978. In 1979, 83 announced acquisitions were of firms valued at $100 million or more—three more than were announced in 1978.

A second trend we recognize at the Bureau of Competition indicates what may already be clear to members of this Subcommittee: Small business appears to be in greater trouble today than ever before. By many economic indicia, small business is enjoying a decreasing share of the economic pie. The situation is particularly acute in manufacturing where the 200 largest U.S. manufacturing firms have increased their share of manufacturing assets from 46 percent in 1947 to 62 percent today. Sales of manufactured goods show a similar picture, with the 200 largest manufacturers increasing their share of sales from 36 percent in 1947 to 52 percent in 1972. Thus, when we look over the economy as a whole, we see that fewer and fewer firms account for proportionately larger and larger amounts of assets and sales.

The same is true when we examine particular industries. For example, a survey by the Census Bureau of 488 industries recently found that the four largest firms controlled over half of the market in 142 of those industries. Concentration of assets and sales in fewer and fewer companies is on the rise, giving small business a smaller share of the economy.

But trouble for the small businessman is a source for concern about the health of our entire economy, because small business has an exceedingly important role to play. There are over thirteen million small businesses in the United States. These small businesses comprise 90 percent of all U.S. corporations. They produce 43 percent of our Gross National Product (over $670 billion), provide 55 percent of the nation's jobs, and significantly, are the most important single source of new jobs in the economy. Between 1969 and 1976, small business created almost two-thirds of all new jobs in the national economy.

It would be quite convenient if we could simply equate the problems faced by small business with the current merger wave. Then, perhaps, we could simply focus on more effective ways of preventing conglomerate mergers and presume that the small businessman's problems would disappear if we were successful. But we are hardly faced with so simple a set of circumstances. It appears to me that some conglomerate mergers probably do have adverse impacts on small business and the local communities directly affected by them. But other mergers may have beneficial effects, while still others may have not much effect at all. Similarly, some conglomerate mergers are anticompetitive under Section 7, while others are competitively neutral or may even be procompetitive. In my view, the impact of conglomerate mergers on small business and local communities is mixed. The conglomerate merger can cut both ways.

I believe a good way to explore this topic is with a pair of examples. First, consider a conglomerate merger involving one of the 200 largest U.S. corporations and a relatively small business. Assume further that the acquired small business is located in a relatively small community and is that community's largest single employer. Until the acquisition, the small business's owners were among the community's leading citizens, active in civic and political affairs. These owners had been satisfied with their return on investment, but the business had not been as spectacularly profitable as it might have been. Further, the owners had had great difficulty securing additional funds to expand and had faced a Hobson's choice: they could either remain in control of the business and watch it decline, or sell out and be able to reap the benefits of their long, hard years of work.

Let me stress at once that, with one exception, all of these factors are external to traditional antitrust analysis of this merger. The one exception is the financial condition of the acquired small business in our example. If it is in a precarious financial situation when it is acquired and meets certain other criteria, it may be a "failing company" and its acquisition may be defensible even if otherwise anticompetitive under well-established Section 7 law. I will return to the problems of failing companies in my second example.

I want, first, to analyze this merger's impact on competition. Presume that the acquired firm is not a failing company. It may be that the acquired company, although rather small, in absolute terms is the leading firm in its industry. Its industry is highly concentrated and characterized by rather high barriers to entry. Moreover, the acquiring firm has seriously been considering entering the industry on its own in the near future. It has the financial resources and the capability to do so, and its entry would mean an injection of new competition that might shake up the industry and make it more competitive, providing consumers with the benefits of increased competition. It is worth noting that by entering on its own, in addition to probably stimulating price competition, the acquiring firm would be creating new productive assets and, presumably, new jobs rather than simply replacing an existing firm. This is one of the reasons why the antitrust laws show a marked preference for internal expansion over acquisition as a method of corporate growth.

Given these circumstances, we would most likely thoroughly investigate the merger and give serious consideration to challenging it, without regard to its possible beneficial or detrimental effects on other small business or the local community involved.

It is possible, too, that the merger in our example does not appear anticompetitive under Section 7. Just the opposite might be true. Thus, the acquired business, although it is the largest single employer in town, might be small when compared to its competitors. The industry might be just as highly concentrated and difficult to enter, but the acquired firm is not a market leader. The acquiring company might be just as likely to enter the industry. But here is the crucial difference. The acquired company may be a small, yet viable competitor with the capacity to expand, but without the resources to do so on its own. The acquiring company provides those resources and, matched to the expertise of the acquired firm, the new business goes on to grow, expand, and indeed challenge the large industry leaders. The small acquired firm thus may be what we in antitrust refer to as a "toehold." In this instance there has been a desirable injection of new competition into the marketplace and we would probably view such a merger as at least competitively neutral, if not procompetitive.

Now let me turn to some of the other effects of our hypothetical merger. Whether the merger is or is not anticompetitive under Section 7, it may have several important effects:

On the positive side, the merger may bring economic stability to the local community. The business, now more likely to outlast the lives of its former owners, may have more of a chance to be a permanent fixture in the community. If the new owners expand the business, the community stands to benefit from the creation of new jobs, both at the business itself and during construction of expanded facilities, and other small businesses in the area, particularly local retailers, stand to reap the benefits of increased sales through the injection of new employment and plant expansion. The local community may also see an increase in its tax base and be better able to provide needed services to all of its citizens.

On the negative side, the local banking and financial community may lose a large part of its business if the new owners decide to take their banking business outside the community, to the distant banks with which the new owners have done business for years. New managers who arrive to run the acquired business may see their posts as only one stop on their way up in a larger, national organization. Tied to the business, rather than the community, they may not take part at all in the community's civic or political life. Or, if they do assume some role, it may only be to insure that political decisions made in the local community do not adversely affect the interests of the business, even though they might benefit the community at large. Significantly, the economic stability created by the change in ownership may be more illusory than real. As I noted earlier, the former owners were willing to accept a modest, rather than a spectacular, rate of return on their investment. The new owners purchased the company for its profit potential. If that potential is not realized, the new conglomerate owners may not be willing to accept less. Their concern is with the overall conglomerate business. The result can be most devastating to both remaining small business and the local community—the closing of the business, with all of its attendant disruptions on the life of the community and other small businesses. Even if the business is sold, rather than closed, it is likely, because of present constraints, to be sold to another large firm, rather than to a smaller firm or an employee or community-based group. The problem that can be identified with conglomerate ownership persists. This is a theme to which I shall return later in these remarks.

My point is simply this: a conglomerate merger may be anticompetitive under Section 7, but feature all of the positive benefits I have mentioned. It may, on the other hand, be deemed harmless under Section 7, but have the potential for causing all of the adverse consequences I have noted. It most likely will fall somewhere in between.

The subject of plant closings raises the spectre of the most serious harm that can come to small businesses and the local community. And that brings me to my second example. Let us assume, first, that the acquired business in my earlier example was facing a precarious financial situation, and was on the verge of bankruptcy. There was no more than a dim prospect that the firm might survive bankruptcy or some other form of corporate reorganization as a going concern. It would probably be faced with liquidation. Moreover, the owners of the business had made a thorough and exhaustive search to locate prospective purchasers, and the only one they could find at any price was the acquiring company. Finally, let us assume that antitrust analysis, focusing on the industry in which the acquisition took place, disclosed that the acquisition was likely to substantially lessen competition under Section 7.

If the acquired company is on the verge of bankruptcy, is unlikely to survive reorganization and can find no alternative purchasers, it qualifies as a "failing company" under existing antitrust laws, and its otherwise anticompetitive acquisition will be excused. The failing company defense to an otherwise illegal acquisition under Section 7 explicitly recognizes the harms that can come to local communities and small business from business failure, and balances those harms against the loss to the economy and society occasioned by a substantial lessening of competition.

The failing company defense was established by the Supreme Court in 1930 in the *International Shoe* [2] case, and was explicitly reaffirmed by the Congress when Section 7 was amended in 1950.[3] The Supreme Court's recent discussion of the defense in the *General Dynamics* case [4], clearly sets forth the balancing of antitrust and other concerns:

"The failing company defense presupposes that the effect on competition and the 'loss to [the company's] stockholders and injury to the communities where its plants were operated' will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market. It is, in a sense, a 'lesser of two evils' approach, in which the possible threat to competition resulting from an acquisition is deemed preferable to the adverse effect on competition and other losses if the company goes out of business." [5]

The failing company defense then is explicit recognition that, at some point, the loss occasioned by a substantial lessening of competition attendant to a merger may be outweighed by the loss to a company's shareholders, its owners, and the local community that would result from its bankruptcy and liquidation.

I should stress that the failing company defense is a rather narrow one, with strict standards that must be met before it will be applied to excuse an otherwise anticompetitive merger. But its strict standards are consonant with the strong congressional policy, expressed in Section 7, of proscribing anticompetitive mergers. Only when an otherwise anticompetitive merger is a company's "last resort" should it be excused.

What about a situation, however, which involves a potential plant closing but does not meet the strict requirements of the failing company defense? The FTC recently has had some experience with this type of situation, when Philip Morris proposed the sale of its American Safety Razor (ASR) division to BIC. This proposed acquisition was not a conglomerate one—it involved two direct competitors in the safety razor business. It serves, however, to illustrate the problems that can arise after a conglomerate merger takes place. Specifically, the ASR/BIC matter illustrates some of the hazards of conglomerate ownership of local businesses. Philip Morris, of course, is a conglomerate firm with interests in tobacco (Marlboro, Merit, Virginia Slims, among others), brewing (Miller Brewing Co.), soft drinks (Seven-Up Co.), industrial products (such items as speciality adhesives and coatings, textile chemicals, and various paper products), and community development and home building (Mission Viejo Co. in Southern California and Colorado). Philip Morris had acquired ASR through merger in 1960.

In 1976, Philip Morris wanted to sell its ASR division to BIC, a French manufacturer of disposable razors. Gillette was the industry leader with 60 percent of the market, while BIC was second with 23 percent and ASR under the Persona label was third with 12 percent. Although Philip Morris did not consider ASR to be in failing condition and although ASR had sales of $41 million, Philip Morris felt that ASR was not profitable enough to warrant retention. Philip Morris indicated to the FTC staff that if the sale to BIC were challenged, it would close ASR and lay off some 800 workers in a southern Virginia county with high unemployment. Our efforts to get Philip Morris to seek alternative purchasers were unsuccessful. After filing a request for an injunction in Federal District Court, we negotiated with BIC and ASR, but the negotiations were unsuccessful. Philip Morris then announced that it would close the ASR plant in Virginia and that the loss of 800 jobs would be the FTC's fault. The company did in fact lay off 250 workers immediately. We encountered a strong response from the ASR union and from some of Virginia's elected officials, but we continued to urge Philip Morris to seek alternative purchasers. Finally, BIC walked away from the deal and ASR's management purchased ASR from Philip Morris with the help of a loan guaranteed by the Commerce Department. While the ASR plant no longer manufactures Persona razors, it does manufacture and sell private label razors and blades.

---

[2] *International Shoe Co.* v. *FTC*, 280 U.S. 291 (1930).

[3] See, e.g., H. Rep. 1191, 81st Cong., 1st Sess. 6 (1949); S. Rep. 1775, 81st Cong., 2d Sess. 7 (1950); *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 319 (1962).

[4] *United States* v. *General Dynamics Corp.*, 415 U.S. 486 (1974).

[5] *Id.*, 415 U.S. at 507.

Philip Morris did not have a valid failing company defense with respect to its ASR subsidiary. ASR was a profitable part of a profitable company. Its conglomerate parent had options other than closing the ASR division or selling it to a major competitor. But Philip Morris was not willing to devote the management time or supply the available capital necessary to rehabilitate or expand the division to a satisfactory profitability level or market share. Philip Morris had not made the diligent efforts required by the failing company defense to locate alternative purchasers for ASR. And ASR faced no imminent danger of liquidation. The only imminent danger ASR and its employees and community faced was the possibility of a self-interested corporate decision by Philip Morris.

While this instance may not reflect a trend, it does suggest that some conglomerate corporations may be following a strategy of discarding rather than rehabilitating units which are either unprofitable or not sufficiently profitable in terms of overall company goals. This strategy is disturbing because it involves the unnecessary elimination of competition and departs from the historical tradition of independent companies' efforts to survive and improve. A conglomerate—lacking community loyalty and playing an investment game with rules different from those that non-conglomerate companies have traditionally followed—can simply write off a line of business, a plant, a work force, or a whole community, and can turn its attention elsewhere, leaving others to pick up the pieces.

I should add, however, that we in the Bureau of Competition are being confronted more and more often with situations in which conglomerate firms attempt to justify illegal mergers and acquisitions by holding employees hostage through the threat of plant closings. For example, just last summer, the FTC was denied an injunction against a horizontal merger between two retail grocery chains because one party to the merger, a large regional chain with 1978 sales of close to $1 billion, threatened to withdraw from the market if the acquisition were not permitted—leaving 850 workers without their jobs. The fact that the failing company defense was not even claimed did not deter the federal court from refusing to issue an injunction in the face of this threat.

What can be done in situations like ASR? One possibility would be to ease the requirements of the failing company defense. For example, a "failing division" defense could be created to address the problem of a profitable firm with a division in financial trouble. But there are several difficulties with such an approach. First, even a slightly less stringent failing division defense would not apply to the Philip Morris/ASR situation where the operation threatened to be shut down is a profitable part of a larger, profitable corporation. There was no division on the verge of bankruptcy there. In addition, by enlarging the defense to cope with situations like Philip Morris and ASR, to allow Philip Morris to sell to BIC, the problem of conglomerate ownership persists. The plant closing may be postponed, but not averted. But, more significantly, it is difficult to make an analogy between a failing company and a failing division. If a corporation has a valid failing company defense, enjoining the merger or acquisition would leave it with only one possible course of action: liquidation. If a firm has a truly "failing" division, enjoining the anticompetitive sale of the division would leave the corporation with at least three choices—liquidation, rehabilitation or lower overall profit levels. The company would still have control of the division's fate. An anticompetitive merger would not be its "last resort." A socially injurious decision by a conglomerate should not be allowed to bend the antitrust laws and make the public accept a substantial lessening of competition and the accompanying economic consequences. When a conglomerate has a reasonable alternative course of action available, it should be seen as extraordinarily reprehensible for the conglomerate to use the threat of plant closings and job losses to achieve its objectives. It is a form of corporate extortion which should be rejected so that other corporations will not be tempted to use similar tactics.

The failing company defense is no more narrow than it must be to comport with the strong congressional policy proscribing anticompetitive mergers which is embodied in Section 7. A discussion of this policy by the Supreme Court in the *Philadelphia National Bank case*[6] shows just how strong it is:

---

[6] *United States* v. *Philadelphia National Bank*, 381 U.S. 321 (1962).

"We are clear . . . that a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid." [7]

The Congressional policy embodied in Section 7 leads me to conclude that the failing company defense should not be expanded beyond its present narrow scope. Similarly, that policy leads me to conclude that the Bureau of Competition is correct, when we focus our attention on the competitive effects of a particular merger in a particular industry, rather than trying to examine in depth the potential adverse effects of a given conglomerate merger on small business and local communities. Moreover, I strongly believe in the enforcement of Section 7 and do not believe that the answer to noncompetitive problems raised by some mergers lies in cluttering Section 7 analysis with a host of new variables, such as whether the local community stands to gain or lose socially and politically or even economically from a given merger.

Still, these nonantitrust concerns are very real. Rather than asking antitrust enforcement officials to include them in their analysis of individual mergers, I believe that a better approach is more fully to address the root causes of many mergers, and seek to provide new alternatives to business. If we seek to moderate the effects of conglomerate mergers and conglomerate ownership, one good way is to develop alternatives that make such mergers, and the resulting ownership patterns, less likely to occur.

I would suggest the consideration of measures that create alternative solutions so that companies will be less likely to consider their only options to be business decline, closing of plants, or mergers that, whether or not anticompetitive under Section 7, have, in addition to or instead of anticompetitive effects, other undesirable effects on the economy and society. Companies need a greater diversity of options.

For example, in the situation of a threatened plant closing as the alternative to an anticompetitive acquisition, private sector solutions may well be possible in a variety of cases, particularly if there are government programs to assist financing. As I mentioned earlier, the management of ASR bought the division from Philip Morris with the help of a loan guaranteed by the Commerce Department.

Similarly, employee or community ownership might be the answer. As the FTC staff analyzes assertions of the failing company defense, we are increasingly asking companies if they have considered selling their plants to employee groups or community groups rather than to competitors. If such a group constituted a viable alternative purchaser, we would reject the failing company defense. This type of solution provides an alternative to continuing conglomerate ownership—the sale from one large, diversified firm to another.

Of course, employee or community ownership programs are not alway ideally suited when a company decides to close its plants. If a company cannot operate a plant at a profit, or if an expensive modernization program is needed to make the plant efficient, the costs and risks to employee groups or community groups may be too great.

Still, this alternative should not be overlooked. We now have the tax laws, for example, which encourage the creation of Employee Stock Ownership Plans (ESOP's). ESOP's have been used successfully on a number of occasions to transfer ownership of plants and divisions to employees, and I anticipate that ESOP's along with other forms of employee ownership, may become increasingly popular and a truly significant—and obviously perferable—alternative to anticompetitive mergers.

We should, however, look beyond solutions to the plant closing dilemma and examine some of the root causes of mergers. If other alternatives to merger are available, I believe many companies will take advantage of them. And there is much that government can do, beyond the antitrust laws themselves, to encourage the development of these alternatives. The development of these alternatives could lead both to fewer conglomerate mergers and to fewer adverse consequences of the conglomerate ownership they create.

Sometimes, for example, the owners of companies, particularly smaller ones, believe they have no choice but to merge with a conglomerate or a larger competitor. They may have exhausted their available capital and are unable to finance future expansion. Without the ability to grow independently, they face only the prospect of business decline unless they merge with a larger firm.

---

[7] *Id.*, 381 U.S. at 371.

Thus, the creation of greater opportunities for small firms to acquire capital should be an important priority for government which can have the effect of lessening the "urge to merge." Some important first steps in this direction are underway. I support the efforts of the Security and Exchange Commission, for example, which has recently adopted a number of rules which would lower substantially the cost of capital formation for small firms already regulated by SEC. I also would note the Administration's recently proposed legislation which would permit small business to sell without SEC registration an unlimited amount of securities to large institutional and private investors, thus bypassing the entire regulatory system with its attendant costs of compliance.

Government regulation, generally, and its attendant compliance costs may be another factor limiting the smaller business' ability to grow on its own, contributing to the urge to merge. I support current efforts by the Administration and Congress to conduct a comprehensive examination of the adverse effect of government regulation upon small business. Similarly I welcome efforts to simplify and ease the regulatory burden placed upon small business. The concept of "two tier" regulation, which recognizes that a regulatory burden acceptable to large firms may put crushing pressure on their smaller rivals has my support, bearing in mind, however that in certain areas, such as health and safety regulation, the imposition of a uniform standard probably is appropriate.

Government tax policy may also be at the heart of some mergers that might not otherwise take place. For example, although some improvements recently have been made, capital gains taxation, while ostensibly a "neutral" tax policy, has had unfortunate consequences from a competitive perspective. Under the present Tax Code, small business owners wishing to sell their businesses are inclined to undertake tax-free stock swaps with large, "blue chip" companies in order to avoid the capital gains tax attendant to sales of stock for cash. This tends to foreclose small businesses from acquiring other profitable small businesses, because small firms generally can offer the selling owners only or the acquiring company's securities, which may be less stable and hence less desirable than the securities of a large firm. This promotes the acquisition of successful small businesses by large firms, and relegates small firms to a position where they must grow by internal expansion or not at all. In the context of the capital disadvantages under which most small firms already operate, the inability of these firms to grow by acquisition widens the competitive gap between large and small firms. This is precisely the trend that should be reversed. I believe that amendments to the Tax Code according differential tax treatment to small and large firms should be explored as possible means by which to strengthen the small business sector, permit it to compete more effectively, and provide alternatives to undesirable mergers.

Mr. Chairman, I have tried to stress in these remarks that concerns over the effects of conglomerate mergers and their effects on local communities and small businesses are best addressed by maintaining the strong antitrust policy of Section 7, while considering new alternatives that might make mergers seem less desirable alternatives. I have not tried to be comprehensive, but only suggestive of some of the ways I believe government can act to make that happen. We at the Bureau of Competition are concerned with the effect of government regulation and other government policies on our work. And we are developing expertise in many of these areas, such as access to capital policies and tax policy, so that we might better advise on how our competitive economic system—composed of many diverse businesses, small and large—can best be preserved.

Thank you again for the opportunity to express these views. I will be happy to answer any questions you may have.

Mr. **Bedell.** Thank you. I want to thank both of you for your testimony. I have a number of questions. If the other members will permit it, I will ask my questions first. It might help our discussion. Is that permissible, Mr. Gonzalez and Mr. Hanley?

Mr. **Gonzalez.** That will be fine, Mr. Chairman.

Mr. **Hanley.** Certainly, Mr. Chairman.

Mr. **Bedell.** Mr. Dougherty, the figures that you gave in regard to the American Safety Razor divestiture by Philip Morris are quite different from the figures that were given to us in earlier testimony. The staff thinks that the figures that you have here are incorrect. Is that not so, staff?

Mr. **Levine**. I think there is a misunderstanding. You said Bic had 23 percent of the market in 1976. I think you meant Schick instead of Bic.

Mr. **Bedell**. We were told that Bic had almost none of the market—2 or 3 percent—in the testimony we had earlier by the people involved.

Mr. **Dougherty**. We will doublecheck the figures. Schick is No. 2; there is no question about it. I do not know what the Bic market share was.

[See below:]

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

BUREAU OF COMPETITION

February 15, 1980

Honorable Berkley Bedell, Chairman
Subcommittee on Antitrust and Restraint of
 Trade Activities Affecting Small Business
House Committee on Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

During the colloquy following my February 7, 1980 direct testimony before your Subcommittee on "Conglomerate Mergers and Their Effects on Small Businesses and Local Communities" a question was raised concerning the market share of the BIC Pen Corporation in the market for the production and sale of razors and razor blades used in "wet shaving" in 1976, when BIC proposed to acquire the American Safety Razor Division (ASR) of Philip Morris, Inc. On page 14 of my prepared remarks, BIC's market share is listed as 23%. In response to the inquiry made during the February 7, 1980 hearing, I have reviewed the Bureau of Competition's files in this matter and find that BIC's market share in 1976 should have been listed as 2.4%.[1] I welcome the opportunity to correct this error for the record.

The Subcommittee expressed some concern about challenging an acquisition involving such an apparently small market share. I, too, share these concerns in an appropriate case. For example, it is clear that Congress never intended for the amended Section 7 of the Clayton Act to reach and prevent "a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market . . . ."[2] The merger of BIC and ASR, however, does not appear to have fit this pattern.

First, while BIC's market share in 1976 was only 2.4%, I believe a good argument could be made that this market share understated its present and future competitive strength. BIC, of course, is a substantial corporation with 1976 sales in excess of $100 million[3] and is a subsidiary of a larger, publicly-held French corporation, Societe BIC,

---

[1] This is the market share reported for BIC at paragraph 19 of the Commission's February 9, 1977 complaint challenging BIC's acquisition of ASR (hereinafter referred to as the "Commission Complaint.") I enclose a copy of the Commission's complaint for your information. I might point out that BIC's reported market share is based upon industry wholesale sales in the United States in the second half of 1976.

[2] Brown Shoe Co. v. United States, 370 U.S. 294, 319 (1962)(footnote to legislative history omitted.)

[3] Commission Complaint ¶3.

S.A.[4] More importantly, perhaps, for this case was the fact that BIC appeared to have been extremely successful in introducing its "BIC Shaver" into the markets in Greece, Italy, Austria, France and Belgium.[5]

Second, ASR was clearly not a "small firm" — it was the third largest producer in the market, and a division of a company with 1976 sales in excess of $4.3 billion.[6] ASR was one of the industry leaders.

Third, the industry was extremely highly concentrated, with the top four firms accounting for about 98.5% of the total U.S. market in 1976. BIC's acquisition of ASR would have increased that level of concentration, perhaps not by much in absolute terms, but in a way the Supreme Court correctly has found to be competitively significant under Section 7:

> [I]f concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great.[7]

I would add that, in addition to the troubling aspects of the BIC/ASR merger as a horizontal acquisition, it also had some disturbing implications for potential competition in this highly concentrated market. It is highly likely that BIC had the ability to become a larger factor in the market on its own. It had already entered the highly concentrated U.S. market, capturing 2.4% of U.S. sales in six months, and it had successfully entered a number of European markets in the recent past. In such a situation, as I pointed out in my recent testimony before your Subcommittee, the antitrust laws tend to favor growth by internal expansion over growth by merger, because among other reasons, new competition is injected into the marketplace — new competition which might lead to substantial benefits to the consuming public, as well as to the economy in the form of new productive assets and new jobs.

Thus, the fact that BIC proposed to acquire ASR, the third largest firm in a highly concentrated industry, when BIC was a recent entrant with the ability to expand on its own and when neither BIC nor ASR was a "failing company" probably contributed, in my view, to the Commission's decision to issue a complaint challenging the acquisition.[8] Concentrating solely on BIC's 2.4% market share in 1976 tends to overlook the acquisition's potentially serious anticompetitive consequences under well-established principals of antitrust law.

---

[4] Id., ¶2.

[5] Id., ¶22.

[6] Id., ¶6.

[7] United States v. Philadelphia National Bank, 374 U.S. 321, 365 n.42 (1963).

[8] As you noted during the hearings, Commission action in this mater pre-dated my term as Director of the Bureau of Competition.

I appreciate the opportunity to correct and clarify the record of my February 7, 1980 testimony before your Subcommittee on "Conglomerate Mergers and Their Effects on Small Business and Local Communities."

Sincerely,

Alfred F. Dougherty, Jr.
Director
Bureau of Competition

Enclosure

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of

BIC PEN CORPORATION,
a corporation, and

PHILIP MORRIS INCORPORATED,
a corporation.

DOCKET No. 9095

COMPLAINT

The Federal Trade Commission, having reason to believe that the BIC Pen Corporation, a corporation subject to the jurisdiction of the Commission, has entered into an agreement to acquire the assets and business of the American Safety Razor Division of Philip Morris Incorporated, a corporation subject to the jurisdiction of the Commission, in violation of Section 5 of the Federal Trade Commission Act (15 U.S.C. Section 45), and which acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended (15 U.S.C. Section 18), and Section 5 of the Federal Trade Commission Act (15 U.S.C. Section 45), and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, pursuant to Section 11 of the Clayton Act (15 U.S.C. Section 21) and Section 5(b) of the Federal Trade Commission Act (15 U.S.C. Section 45(b)), stating its charges as follows:

I. BIC PEN CORPORATION

1. Respondent, BIC Pen Corporation, (hereinafter "BIC") is a New York corporation with its principal office and place of business located at Wiley Street, Milford, Connecticut.

2. BIC is a publicly held corporation listed on the American Stock Exchange. BIC is a subsidiary of Societe BIC, S.A., a publicly held French corporation. Societe

BIC holds voting trust certificates which represent 57% of the outstanding common shares of BIC. Marcel Bich, a trustee of the voting trust is the only individual who may vote the shares of the trust.

3. BIC is a manufacturer and seller of writing instruments, disposable butane lighters, pantyhose and disposable shavers. In 1976 BIC was the largest seller of writing instruments, and a leading seller of disposable butane lighters in the United States with sales of over $100 million.

4. At all times relevant herein, BIC has sold or shipped products in interstate commerce and was a corporation engaged in commerce as "commerce" is defined in the Clayton Act, as amended, and was a corporation whose business was in or affected commerce within the meaning of the Federal Trade Commission Act, as amended.

II. PHILIP MORRIS INCORPORATED

5. Respondent, Philip Morris Incorporated (hereinafter "Philip Morris") is a Virginia corporation with its principal office and place of business located at 100 Park Avenue, New York, New York.

6. In 1976, Philip Morris had sales of approximately $4.3 billion, operating income of $600 million, and assets of $3.5 billion.

7. Philip Morris is a diversified company engaged in the manufacture and sale of cigarettes, beer, razors and blades. It is the 74th largest industrial company in the United States. It states that it is the second largest of the six major cigarette manufacturers in the United States, and is the second largest publicly-held cigarette company in the world. Philip Morris' subsidiary, Miller Brewing Company, is the third largest United States brewer.

8. The American Safety Razor Division (hereinafter "ASR") of Philip Morris is the third largest domestic manufacturer of razors and blades and the largest private label razor blade manufacturer in the United States.

9. In 1976, ASR's sales were $42.3 million and its income before taxes was $1.5 million. Its sales of razors and blades domestically were $29.5 million.

10. ASR manufactures the "Personna" "Gem" and "Flicker" lines of razors and blades, and manufactures industrial and surgical blades.

11. At all times relevant herein, Philip Morris has sold or shipped products in interstate commerce and was a corporation engaged in commerce as "commerce" is defined in the Clayton Act, as amended, and was a corporation whose business was in or affected commerce within the meaning of the Federal Trade Commission Act, as amended.

III. THE PROPOSED ACQUISITION

12. On December 30, 1976 BIC and Philip Morris entered into an agreement for BIC to purchase the business and substantially all the assets of the ASR Division for approximately $20 million.

IV. TRADE AND COMMERCE

13. The relevant geographic market is the United States as a whole.

14. The relevant product market is the production and sale of razors and razor blades used in "wet-shaving."

15. In 1975, approximately 1.8 billion razor blades were sold in the United States at retail. The retail price of razors and razor blades sales was approximately $385 million and the value of factory shipments was $250 million.

16. Concentration in the production and sale of razors and blades is extremely high with the top four firms accounting for approximately 98.5% of total U.S. retail and wholesale sales in 1976.

17. Barriers to entry into the production and sale of razors and blades are substantial.

V. ACTUAL COMPETITION

18. In 1976 ASR was the third largest producer and seller of razors and razor blades in the United States with approximately 11% of wholesale shipments.

19. In July, 1976, BIC began to sell its disposable razor (the "BIC Shaver") in the North Central Region of the United States. In this limited geographic area and time period, BIC sold over 32 million BIC Shavers with factory value of $3.2 million. This amount accounted for approximately 2.4 percent of industry wholesale sales in the United States in the second half of 1976. In 1977, BIC commenced selling the BIC Shaver nationwide.

20. BIC and ASR are direct and substantial competitors in the production and sale of razors and blades in the United States. The acquisition of ASR by BIC will eliminate substantial actual competition.

VI. POTENTIAL COMPETITION

21. BIC is a significant potential competitor in the production and sale of razors and blades by reason of, among others, its being an aggressive competitor in other products and markets, and its stated intent, aggressive actions, size, financial resources, and marketing, manufacturing and technical capabilities.

22. The BIC Shaver, which was introduced in Greece in late 1974, has captured approximately 40% of the razor blade market there. More recent introductions of the BIC Shaver have captured 15 to 20 percent of the market in Italy and Austria, and 10 to 15 percent of the market in France and Belgium.

23. Acquisition of ASR by BIC will preclude ASR from expanding into the disposable razor field which would make ASR a stronger competitor in the market.

24. BIC is the most likely competitor on a significant scale in the production and sale of razors and blades and is the only reasonably foreseeable company which can develop into an actual competitive force capable of offering significant competition to the four major domestic razor blade companies.

25. Manufacturers of razors and razor blades have perceived BIC to be a likely future significant competitive force on the fringe of the market and have modified their behavior in a pro-competitive manner in anticipation of BIC's entry.

VII. EFFECTS OF THE ACQUISITION

26. The effects of the acquisition of ASR by BIC may be substantially to lessen competition in the production and sale of razor blades throughout the United States in violation of Section 7 of the Clayton Act, as amended, and the effects of the acquisition may be unreasonably to restrain trade and to hinder competition unduly in the production and sale of razors and razor blades thereby constituting an unfair method of competition in commerce, in violation of Section 5 of the Federal Trade Commission Act, as amended, in the following ways among others:

(a) Actual competition between BIC and ASR in the production and sale of razors and blades will be eliminated.

(b) The substantial likelihood of reduced future concentration in the razors and blades market through the continued strength of ASR as a significant competitor in that market will be diminished or eliminated.

(c) Significant potential competition between BIC and producers of razors and blades, including ASR, will be eliminated.

VIII. VIOLATIONS CHARGED

27. The agreement for the acquisition of ASR by BIC constitutes a violation of Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. Section 45), and the acquisition by BIC of ASR, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, (15 U.S.C. 18) and constitute a violation of Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. Section 45).

WHEREFORE, the Federal Trade Commission this 9th day of February, A.D., 1977 issues its complaint against the said respondents.

Mr. **Levine**. I believe it was 2 to 3 percent.

Mr. **Bedell**. I should tell you that the witnesses we had before were not certain if their figures were correct. Maybe the staff can tell me. Their figures indicated that Bic had in the area of 2 or 3 percent of the razor blade market.

Mr. **Levine**. That market share figure is correct and was obtained in a regional test market.

Mr. **Bedell**. Gillette had 60 percent of the national market, if I remember correctly. It was difficult for us to understand how the Federal Trade Commission could say that it would not increase competition for a firm with 2 percent of the market to merge with another firm with 12 percent of the market. It would seem to us that if you are going to have competition someone had better challenge Gillette who had 60 percent of the market.

Mr. **Dougherty**. I may have to beg off on the thinking of the Commission or the staff at that time, Mr. Chairman, because I was not at the Commission then.

It is my understanding of the situation, however, that it was a clear, horizontal acquisition which the Commission felt that it could successfully prosecute for an injunction in Federal district court and a clear violation of the antitrust laws. But you have raised an interesting policy question and it really goes to prosecutorial discretion and what Mr. Litvack was talking about earlier. That is, in some situations where you have a highly concentrated market and where you have a couple of firms that appear to dominate that market——

Mr. **Bedell**. Which would be Gillette and Schick.

Mr. **Dougherty**. Which would be Gillette and Schick. Perhaps there are instances where it might be better to allow two smaller firms to merge even though that might be a so-called horizontal acquisition and perhaps in violation of the antitrust laws to provide a strong No. 3, or a strong No. 4, in the industry.

I think there are situations where I would recommend, as the Director of the Bureau, not to proceed in those types of situations. Whether this was one of those situations, I really don't know.

Mr. **Bedell**. The testimony we had last week from ASR officials indicated that Philip Morris told the Federal Trade Commission that if the sale was not permitted, they were going to close down the plant. As it worked out, the employees were able to organize and keep the plant operating. In the *Youngstown Sheet & Tube* case, we found that the employees were not able to organize successfully. I assume there was no evaluation in either case, that indicated an employee ownership venture would be successful.

Is the FTC required to give consideration to the possible success of employee ventures under current laws and regulations? Is there consideration given to the effect upon the community and the employees when the FTC judges whether a merger should be approved or disapproved?

Mr. **Dougherty**. Absolutely. But you have to be careful, Mr. Chairman, to recognize that the failing company defense is a very narrow one and strict. If the representation of the company is taken at face value, we will be faced with that argument on almost every acquisition. In fact, as a result of the *Youngstown* case, and *Bic-ASR*, and the *Federal Glass* case, which is a situation similar to

Bic-ASR and which I was more directly involved in, we are being confronted more and more with those type arguments.

There is a responsibility placed on the firm that is a failing firm to provide the information and to show that it will not survive financially, that it has made its best efforts to find an alternative purchaser, and so on. Very often a firm will come forward and say that they are going to close their plant if they are not allowed to sell it. When you ask for the financial information, and when you ask for the demonstration that the firm has sought out alternative purchasers, that followup information is not forthcoming. So, under the law you have no choice but to make the proceeding turn on whether the merger would be anticompetitive under Section 7, rather than its failing company aspects.

Mr. **Bedell.** Do I understand you to be saying that the only thing under the law you are supposed to consider is whether a firm is competitive or noncompetitive. The failing company doctrine is of some help, but very limited help in that regard.

Mr. **Dougherty.** That is a part of it. The other part is that we do have an obligation under Section 5 of the Federal Trade Commission Act to only take enforcement action if it is in the public interest. The Commission does look at items like possible plant closings, possible unemployment and the items that you are concerned about for the local communities and small businesses in making that decision. We have a limited number of resources and can only employ them in a certain number of cases. That goes to the prosecutorial discretion element of the equation.

Mr. **Bedell.** I guess that brings us to you, Mr. Litvack.

Is that one of your considerations in the Justice Department also? Does the effect upon the local community help decide whether merger should be permitted or not?

Mr. **Litvack.** As I indicated, Mr. Chairman, in my statement, in a close case those kinds of factors inevitably come into play on the question of prosecutorial discretion, that is, whether to bring a case or not to bring one.

I think you have to divide the point into two exercises. One is the legal one, which is really the second one. I will take that first, though. When you bring a lawsuit and you are challenging an acquisition, the failing company defense does not come into play at all until you have decided whether the acquisition is otherwise illegal, or stated differently, that it is anticompetitive.

Now the question for the court in that context is this. Should we allow it nonetheless because the alternative, that is, that the company is going to disappear anyway, is a less attractive alternative and there is no other viable buyer? That is the legal context once you are in court. At that point, whether a plant is closing or not closing is only part of the total question of whether the company is going to fail. When you go back a step and you are first presented with the decision of whether or not to sue—and I must quickly say what I know the chairman and the committee knows, of course—that I have been in this job for all of 3½ weeks and that my experience is really on the other side as defense counsel coming in and talking to the Division rather than making these decisions——

Mr. **Bedell.** It is very wise for them to send people who have only been on the job for 2 or 3 weeks because they are not accountable for past situations.

Mr. **Litvack.** I will try to answer it as best I can, and I am not begging off on those grounds. I am just saying that, to some extent, I have perhaps what is a different and may be even a helpful perspective since I have been on the other side of the situation. When you do come in, in my experience to talk to the Division, to answer your question, is a plant closing, for instance, a factor taken into account? The answer is "Yes," in a close case if the other factors leave you hanging on the question of the anticompetitiveness of the merger. If you have a clearly anticompetitive merger—the mere fact that someone comes in and tells you a plant will be closed—everyone is going to come in and tell you that. I will put it this way. It is sort of like the child who says he is going to hold his breath if you don't let him do it his way. They say they will close the plant.

If you become hostage to that argument in every case, you just might as well go out of business. So, the answer is that you have to assess it only in those cases where you really have a close call on the competitive aspects of the acquisition.

Mr. **Bedell.** One of my concerns is Youngstown Sheet & Tube takeover by Lykes. It is apparent that people at the Justice Department said that if this merger is permitted Youngstown Sheet & Tube will go bankrupt in 10 years. It turned out the fellow was wrong; they went bankrupt in 9 years instead of 10.

Mr. **Litvack.** That is a pretty good track record.

Mr. **Bedell.** The concern I have is that if the Justice Department foresaw Sheet & Tube's failure, then it certainly was not in the best interest of anybody to see the company go bankrupt, resulting in a loss of jobs and causing economic hardship in the Mahoning Valley. Even though it appeared to some of the people in the Justice Department, that this merger would harm the Valley, was the merger permitted because of the laws that govern antitrust activity? The purpose of these hearings is to try to determine if these laws need to be changed in order to better reflect the interests of society.

Mr. **Litvack.** My understanding on that situation which, as you know, was some 10 years ago——

Mr. **Bedell.** More than 3 weeks ago, when you were hired.

Mr. **Litvack.** Considerably. My understanding, however, to answer your question as to circumstances which led to a nonprosecution, is as follows. No. 1, of course, a member of the staff had a prediction that came to be true. One could not be certain at the time, but it was a reasonable prediction and indeed turned out to be 100 percent accurate.

I think at the time, as I understand it, you had just started the wave in 1969 and 1970, or 1968–69, of the conglomerate merger boom. This was the first boom—ITT and a host of other companies out there, including LTV—making a host of acquisitions. The whole question of conglomerate theory under the antitrust laws was evolving. The Department of Justice brought two major cases at that time. One was against ITT up in Hartford, and one was against LTV. I think, in large part, the thinking was that with those two cases out there requiring major commitments of manpower, No. 1, and, No. 2, major commitments to a new theory which we were testing in the courts, that something had to go and something had to stay. They challenged the two and were ultimately unsuccessful, that is, they settled one and were unsuccessful in the other. This one was not challenged for that reason.

Mr. **Bedell**. You mean the Justice Department didn't have time because of the other things they were doing?

Mr. **Litvack**. I think it is a balance of both time and resources and that if you are going to try to develop a new theory in the courts, you pick a couple of cases and you try to develop them. You can't have 20 of them.

Mr. **Bedell**. What I should tell my people back home is that there are not enough lawyers in the Government to adequately prosecute our laws. It is going to be hard for me to convince my constituents of this.

Mr. **Litvack**. If I gave that impression, Mr. Chairman, I did not mean to. That is not a fair conclusion. I think they do have the resources—obviously, there are constraints upon any enforcement agency, but here there is a second practical one. They were trying, as I understand it, at the time to develop a new theory in the courts. They brought two test cases to do that. They did not bring the third.

Mr. **Bedell**. I don't want to abuse my time prerogatives, but I do have about one more question I would like to ask. United States Steel, again, in Youngstown, is not willing to sell their plant to an employee stock ownership trust, should one be formed. Are there any laws that prohibit a company from closing a plant rather than selling it to people who could keep the plant operating. Are they free to close that plant if they want to? Can they say, We don't care what it does to the community. We don't care about anything else. We have decided that it is in our best interest to close the plant down for whatever the reasons. Tough luck to the city of Youngstown?

Mr. **Litvack**. Passing for a moment areas in which I am not expert, such as labor laws and what constraints there are, if any, on the situation, I would say as a matter of pure antitrust law, and passing for a second the question of motive, if you just ask if there is anything which stops a company from closing its plant because it decides it is not making enough money, for instance, there is nothing in the antitrust doctrine that I am aware of that would prevent that.

Mr. **Bedell**. Mr. Dougherty, I understand the FTC has been looking at this.

Mr. **Dougherty**. I agree with Mr. Litvack's characterization of the state of the law. We began only yesterday to start looking at the situation in response to urgings from our Cleveland regional office staff. I really don't know the facts in this situation, Mr. Chairman. I am concerned about the implications of a plant closing for the local community, and I believe that there are issues in that area that should be explored in some depth by the Congress. For example, as we have testified before the Senate Judiciary Committee, we would recommend some kind of prenotice to be required by large firms. This would be a prenotice to the governmental agencies like the Commerce Department and to the communities so that the communities could begin to react to the prospect of a plant closing.

I believe that there should also be a better coordination at the Federal level between all of those agencies that should be involved if there is a plant closing. It could be the antitrust agencies. In many instances it would not be because we might not have an acquisition involved, for example. However, community groups and workers cannot very often put up with the time constraints of trying to get an EDA loan, for example. We saw that in the *Federal Glass* case where we had an employee group that was interested in exploring the possibility of buying the plant and it fell through because it was going to take too long for them to get the capital. That was intolerable to the conglomerate involved.

Mr. **Bedell**. Thank you. I have a number of other questions, but I would like to hear from other members of the committee. Mr. Hanley?

Mr. **Hanley**. Thank you, Mr. Chairman.

Mr. Dougherty, I note your disclaimer on the first page of your testimony. Along with that is it reasonable to assume that the Commission supports a different position from the one you have articulated?

Mr. **Dougherty**. It is a standard disclaimer, Mr. Hanley, for any staff member that testifies or gives a speech. I just can't say what position the Commission would take if the Commission were asked to testify on these matters. I don't think it would be substantially different.

Mr. **Hanley**. You feel that generally speaking the Commission would be in accord with what you have said here today?

Mr. **Dougherty**. I can't say that. What I can tell you is the process through which we go before we testify. We request to testify. We draft the testimony. My appearance is approved by the Commission after they have looked at the testimony. It is circulated to the Commissioners, they read it, and if they want it changed, I change it. I assume there would not be any substantial disagreement.

Mr. **Hanley**. Fine.

As I think of your folks being the watchdogs, so to speak, with respect to competition in the American marketplace, it comes to mind one of my great pet peeves. That is the bread industry in America. I have faulted the Commission for a long period of time and particularly a few years back when I was more involved than I am today for letting occur what was apparently occurring in the marketplace. I observed the Commission burning up an awful lot of time on triviality, if you will, and letting the big stuff fall down between the cracks.

So, over the course of time we have noted that the conglomerates moved in, took over the bread industry, and I believe today—correct me if I am wrong—that the conglomerates account for something like 74 percent of the American bread market having virtually driven the independent baker out of business. There are very few decent sized independent bakers left in America. In my home State, New York, you can count them on one hand.

Back when I was more involved, and I had a specific case that was terribly upsetting to me, and I was pounding at the door of the Federal Trade Commission to get on it. For some reason unbeknown to me that I was never able to determine, they were a little bit reluctant to tackle it. Back then I asked the Council on Wage and Price Controls to take a reading and come back and tell us if the marketplace really was being best served from the standpoint of bread. Are the people getting a better quality at a better price? My fears were founded by that report back then which expressed the fact that unfortunately, no, they were not. The American consumer was adversely affected by the conglomerate takeover of the bread industry because the quality was not at all as good as it would have been under the independent baker concept and, worse yet, the American housewife had to pay considerably more for that loaf of bread than she would have had competition prevailed.

I felt then, as I feel today, that FTC was indeed, and is indeed, derelict in its responsibility for not having protected the consumer—that housewife, the captive consumer, if you will—who goes into that market for that basic foodstuff and today has to pay 70 plus cents for that loaf of bread. She would not be paying, that even with inflation what it is today, much more than 40 cents if healthy competition prevailed in the marketplace.

Do you have any comments on that one?

Mr. **Dougherty**. I do not know when you were complaining to the Commission but the Commission issued a complaint against ITT Continental Baking—I believe it was in 1975—charging them with monopolizing the bread market and with price discrimination. We have been litigating that monopolization case. It is one of our major monopolization cases in the Bureau. We have been litigating that case since that time.

I share your concern and interpret your concern that very often the antitrust laws are not applied in time. One of our problems is that we very often are faced with the situation where monopoly is in place and many of the innovative, small, independent concerns are gone. I think that we should try to do a better job to get in sooner, but the Commission is deeply involved with the problem that you are concerned about, and I believe that we are doing all that we can right now.

Mr. **Hanley**. If the gentleman will yield, I guess then probably what you are saying to me is this. Unfortunately, and I can understand this, the legal resources of the Commission can in no degree match the legal resources of the conglomerates. Would that be a fair statement? I have argued this point many times, and I have tried to stress the necessity of providing more in the way of resources to the various Federal agencies for this express purpose. Would you agree with me on that?

Mr. **Dougherty**. I certainly would agree that the antitrust enforcement agencies could use more resources. I say that with some trepidation as we are all being scrutinized very carefully in a time of budgetary constraint.

Yes; we could. But, in terms of litigating that case, I think we are holding our own, and I think in most of the Government actions that I have seen on both sides of the fence the Government holds it own pretty well. We have some problems. We have turnover problems. It is hard to hold senior experienced litigators when they can walk down the street and make three or four times as much. Otherwise, I think we hold our own pretty well.

Mr. Bedell. Will the gentleman yield?

Mr. Hanley. I would be delighted to yield to the chairman.

Mr. Bedell. My personal belief is that if the Federal Trade Commission transferred lawyers from the Consumer Division to the Antitrust Division, they would make Congress very happy. I believe the FTC would get at the root cause of the problem rather than scratching the surface. That is only my personal opinion, but I think the FTC should consider the present political realities.

Mr. Hanley. Thank you, Mr. Chairman.

In addition to the hurt imposed upon the consumer and of course as this litigation has endured in the meantime the industry—the independent segment of the industry—is being destroyed. I think the catalytic force that drove me a few years back was when I saw a small bakery in a small community so involved. It happened to be the major employer in that particular area, a community with a population of about 20,000 people. It happened to have a fine traditional bakery that served that general market and happened to employ 375 people directly. All of the services required to make that bakery operate were purchased from that locale. Of the fleet of 120 trucks, all of the tires came from the tire merchants. Everything that went into that particular operation came from that general locale. So, safe to say, along with the 375 direct employees there were probebly another 150 employees in that community that were adversely affected.

So that industry, as viable as it was, just could not beat the forces of ITT. Continental swooped in, scooped up the marketplace, and ultimately drove the industry into bankruptcy. It displaced all of these people. The community itself today or since that time—I guess it is 4 years now—as opposed to the nice spinoff of that local industry ITT's tractor-trailers swoop in through the dead of night, drop their product off at random in the various towns of that area and go about their business, not spending 5 cents in that general market area. That is part of the tragedy.

So I guess it goes back to shortfall from the standpoint of legal resources within the Commission. I would applaud what the chairman has suggested—perhaps a transfer of some of that talent into your Division might help. Then we could do something that might exhilarate the litigation process before they have 100 percent of the marketplace. Otherwise we might hear "A loaf of bread is now $2, my friend, take it or leave it."

Do you have any comments?

Mr. Dougherty. I have a quote that might be of interest to the committee. It is from the "Small Business—New Directions for the 1980's" by James Morrison. I quote this paragraph.

> A University of Wisconsin professor of business administration, Jon Udell, studied the local effects of mergers in Wisconsin. Here are some of his findings: (1) 70 percent of the merged companies shifted their patronage from local banks to the bank of the parent company; (2) 70 percent of the acquired companies shifted from the use of local accounting firms; (3) 75 percent of the merged companies shifted their legal business away from local attorneys; (4) Wisconsin suppliers of goods and services consistently lost business when merged firms began centralized purchasing of supplies through parent corporations; (5) 55 percent of the merged companies had declines in their growth rates after acquisition; and (6) corporate gifts to the com-

munity and to charity were less for the merged firm than for independent businesses.[1]

Mr. HANLEY. I thank the gentleman, and I thank you, Mr. Chairman.

Mr. BEDELL. Thank you. We appreciate your bringing those last figures into the record. I think they are significant. Mr. Gonzalez?

Mr. GONZALEZ. Thank you, Mr. Chairman.

First, I wish to thank the two gentlemen for taking time to appear before the subcommittee. I think we really should express our gratitude.

Second, I should make an observation.

The observation is that I especially am grateful for their presence here at a time when obviously the House, and perhaps the Congress, is emasculating this particular agency in the name of freeing business from improper governmental domination and so forth. However, it really stems from the resistance of the special interest to the efforts that have been made and, as some you say, unsuccessfully, to regulate effectively and realistically which, as you well know, since its inception the Commission has found at times very difficult.

The other observation I think in all fairness I should make is this: In the questions and comments made by the chairman and our colleague from New York, the inference is that perhaps the legal talent available to the Government doesn't match that—it does not match it in compensation. It does not match it in the stable of sustained lawyer facilities and plush offices. That has always been true. What I think we would be very unjust to forget is that despite those handicaps and obstacles this agency in particular has produced such eminent and successful lawyers as Everett McIntyre, who has been most helpful to the Congress and has worked for the Congress but whose claim to fame came in the service as a lawyer for the Federal Trade Commission and then later as the Commissioner himself.

I think that rather than go back and explain to the folks why, I think, like Pogo, we should say that we have met the enemy and the enemy is us, the Congress. I think it really has been right here in the Congress because you will find that it isn't the legal staff. It is rather the political element that is going to shape the policy. Presidents do have a tendency to appoint Commissioners who might have a preselected policy with respect to some areas such as the Robinson-Patman Act, for example. There, if we trace the history, its enforcement, lack of it, or availability, you will find that there is a cycle. It depends on what the philosophy is in the Commission more than it is on the staff. I thought that in all fairness we should show that in the record.

One question I do have at this point in my remaining time——

Mr. HANLEY. Would the gentleman yield at this point?

Mr. GONZALEZ. Certainly.

Mr. HANLEY. Everett McIntyre and I agree with you. He is just a fine, wonderful person who has served such a meaningful purpose. But I would just remind you that this was his training ground, remember? And that great colleague from your great State was his mentor, Wright Patman. So after he was trained in the Congress, we sent him over to FTC where he did a magnificent job.

---

[1] Committee Note: The full text of Jon Udell's study can be found in Appendix M.

Mr. **Gonzalez**. As a Commissioner, but actually Mr. Patman got him from the legal staff of the Commission—in the inception. He was lucky enough to be able to attract him and get him over here into the House, on the House staff. He really had years of accumulated experience as a lawyer with the FTC.

Mr. **Hanley**. He was just a great fellow. I am in complete agreement.

Mr. **Gonzalez**. He is one. I could mention others—Dr. Justinus Gould, former General Counsel of the committee, for instance. He had a tremendous record of accomplishment as a lawyer for the Government even though the pay wasn't comparable. I really think it is only fair to say that. The record shows that despite the low pay legal staffs have done a great deal. I am not conversant with this present structure of staff distribution to say that I agree with the chairman or my colleague from New York that if we shift from one Bureau to the other that—I really don't know. I don't know how to judge that. Maybe it would be. But, as to the effectiveness and the caliber and the quality of talent, I don't think the record ought to show any kind of apology, particularly in the FTC.

The question I did have is this. Perhaps it is not altogether related but it is somewhat because of the nature of the testimony and the locus of discussion and concentration on it. That is, a few years ago I was one of those who voted reluctantly and with a great deal of apprehension where the so-called Failing Newspaper Act was concerned. I think if I were to search my soul, I would have to admit it was one of my cowardly moments when the doubts were overcome by some very, very effective lobbying by my local newspaper people and also because of the colleague handling it who happened to be then the Representative from Hawaii—now the Senator—Mr. Matsunaga. There was very little resistance except that some of the arguments that had arisen in my mind were never addressed and never answered.

In effect, it was an exception that the Congress was making from the antitrust coverage with respect to failing newspapers. I am just wondering if the Commission has any records or has any evidentiary documentation showing what, if anything, resulted statistically since the enactment by the Congress of the Safe Newspaper Act which, in effect, was an exemption? Do you have any information, or would it be possible to make such a request at this time with the hope that at the proper and convenient opportunity we could get a report? It has a lot to do with this. You are talking about failing businesses in steel, and so forth. We went through that with respect to newspapers.

Mr. **Dougherty**. Mr. Gonzalez, I do not know of any such information or report that has been done by the Commission. However, I will go back and doublecheck and respond to you and to the subcommittee.

Mr. **Gonzalez**. I would appreciate it deeply. I think it would be in keeping with us looking at this from the full perspective.

As I see it from our standpoint, Mr. Chairman—and I have said this with respect to the other matter, the Robinson-Patman Act—we are dealing in an area in which actually we have sort of a coresponsibility with the Judiciary Committee. Were we to come out with suggested legislation we probably might as a matter of legislative courtesy more or less have to work with the Judiciary Committee. I am not too sure. The chairman probably knows better than I do. But, this is a very much related experience already. This is true not only in legislation but in business experience because we were told unless this is passed, and unless we are exempted, you will have the continuation of the disappearance of many more daily newspapers unless they are able to merge, even in a single city. In some respects and in some working capacities so as to minimize any possible conflict with the antitrust laws—it went over overwhelmingly, if I remember correctly. I think it would be good to bring in a parallel situation here and see what, if any, effect there has been or what has been the rate of decrease in the number of newspapers since its passage. What availability has been made by the newspapers because of the law—perhaps that is on record, maybe it isn't. I for one would be deeply grateful if we could have that, and I feel it would be helpful to our consideration of whatever legislation is presented.

Mr. **Bedell**. Would the gentleman yield? I think Mr. Litvack, who has done some work in this area could be of help.

Mr. **Litvack**. We can probably furnish you with information on that, Mr. Gonzalez. More specifically, the Newspaper Preservation Act, which went into effect in about 1970, provides in essence for an administrative procedure whereby ultimately the Attorney General makes the decision, based on a hearing and recommendation from an administrative law judge, with respect to joint operating agreements which come within the ambit of the act.

My recollection, and we will furnish you the information, for now is this: There have been two such proceedings to date. The most recent of these was concluded not very long ago, just a matter of a few months ago, in which the Attorney General affirmed the administrative law judge's recommendation for approval of a joint operating agreement between two newspapers in Cincinnati, Ohio.

My further recollection is that there was one earlier proceeding for which I think the recommendation was negative and then the parties abandoned the agreement. I will have to get you the information. But just by way of a thumbnail sketch, that is my recollection.

Mr. **Gonzalez**. I appreciate that. I also will be grateful for whatever you can do.

Mr. **Bedell**. Without objection, the record will remain open at this point for the purpose of inserting the additional information requested by Mr. Gonzalez.

[Material to be supplied follows:]

United States Department of Justice
WASHINGTON, D.C. 20530

ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

FEB 15 1980

Honorable Henry B. Gonzalez
House of Representatives
Washington, D.C. 20515

Dear Congressman Gonzalez:

I enjoyed having the opportunity last week to discuss the issue of conglomerate mergers with you and other members of the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business. In the course of that discussion, you expressed interest in the operation of the Newspaper Preservation Act of 1970, 15 U.S.C. §§ 1801-04 (1976).

The Newspaper Preservation Act provides an antitrust exemption for joint operating agreements among competing newspapers whenever the Attorney General certifies that no more than one of the parties is other than a failing newspaper. Joint operations are then permitted only with respect to business, production and distribution; separate, independent editorial and reporting staffs must be maintained. Thus, the Act sets out conditions under which a failing paper may be saved short of a complete takeover.

As I mentioned at the hearing, application of this statute has been quite limited. In the ten years that the Act has been in effect, there have been only two applications for certification of new joint operating arrangements, although 22 such arrangements already in effect in 1970 were given provisional approval in the Act. The first application, concerning an agreement between newspapers in Anchorage, Alaska, was approved in 1974. The joint operations have since been terminated. More recently, the Attorney General approved a request from the Post and the Enquirer in Cincinnati. In this case, at the recommendation of the Antitrust Division, there was a full seven-week evidentiary hearing before an administrative law judge on the Post's application for certification as a failing newspaper. The Antitrust Division participated fully in the hearing and supported the administrative law judge's recommendation that certification be granted.

I hope this information will be of interest to you with regard to your concerns about the effect of the Newspaper Preservation Act. If you have any further questions about this matter, please feel free to contact me.

Sincerely yours,

Sanford M. Litvack
Special Assistant to the
Attorney General

cc: Honorable Berkley Bedell

Mr. **Hanley**. Would the gentleman yield?

Mr. **Bedell**. Certainly.

Mr. **Hanley**. The instance to which you referred—the joint operating—does that remain two separate ownerships?

Mr. **Litvack**. You have a joint operating agreement, Mr. Hanley. You have two separate editorial policies. They are required to keep them separate. What you have is a sort of joint production facility.

Mr. **Hanley**. But is it a single ownership of the two?

Mr. **Litvack**. No; not necessarily. It is just an agreement to operate and get the efficiencies from the operation. That is the concept.

Mr. **Hanley**. They remain two separate ownerships but simply use the same facilities and plant——

Mr. **Litvack**. The editorial policies must remain separate.

Mr. **Hanley**. I see. Thank you.

Mr. **Gonzalez**. Thank you very much, Mr. Chairman.

Mr. **Bedell**. Thank you.

I would like to say that it was not my intent to place blame on either of your organizations. I agree with Mr. Gonzalez that Congress itself shares part of the blame. If we are going to be honest about this situation, as Mr. Dougherty has so clearly said. the fact is that we all are failing. He has stated that the 200 largest manufacturers increased their share of assets from 36 percent in 1947 and 52 percent in 1972. We are moving toward a society dominated by a small number of large corporations, and it has become more and more difficult for the small entrepreneur to exist in our economy.

I am not blaming your agencies, but you are two of the people who have the responsibility of trying to correct that.

I read in your testimony that you think our current laws are inadequate to deal with the problems of the small entrepreneur. The purpose of these hearings is to explore suggestions as to what laws should be enacted or changed to direct our society in a healthy direction. Mr. Dougherty, you mentioned changes in our tax laws. I am one of those who believes that one answer would be a truly progressive income tax. Our tax code should encourage the operation of small businesses as separate entities, rather than encouraging their acquisition by large corporations. I have worked hard for those changes, but the likelihood of getting them accomplished in the present political atmosphere is not very great.

Our challenge is to determine what we should do to bring about changes to make it possible for a small businessman to live and thrive, and for communities to continue to operate with businesses that are interested in their welfare.

What do you feel would help you do your job to reverse the trend we see of the declining role of small business in our society?

Mr. **Litvack**. As I indicated, Mr. Chairman, the Antitrust Division for its part, although the matter is still open for debate within the administration, has proposed legislation designed to deal, at least in part, with some of the problems that we have identified. As I indicated in my prepared testimony, and as the chairman correctly noted, we think there are, as a practical matter, real problems in the courts today under the existing antitrust laws to deal with the kinds of questions you are talking about.

The legislation that we have suggested is designed, as I said, to deal with part of it. Simply and briefly summarized, it would place in the first instance the burden upon a large conglomerate, as defined, seeking to acquire another company to show that the preponderant effect of the acquisition would be substantially to enhance competition.

As the chairman knows, and as Mr. Gonzalez knows, the thrust of the antitrust laws today is that the Government under Section 7 of the Clayton Act must come in and prove a probability of a substantial lessening of competition in narrowly defined, specifically defined, product and geographic markets. This proposal would reverse that and say that if you want to acquire, you must show that there is likely to be, or the preponderant effect would be a substantial enhancing of competition. It will be pro competition. We think that proposal would go a long way toward dealing with some of the problems that we see, at least in the antitrust area. It is not to say that it is mutually exclusive, but in the antitrust area we think it is a viable, reasonable proposal and one which we have in fact proposed.

Mr. BEDELL. Where is that legislation?

Mr. LITVACK. Over on the Senate side, there is a bill introduced by Senator Kennedy, S. 600, which does not match up on all fours with what I am saying, but it has the concept. We have been working with the Senate Judiciary Committee and discussing that kind of thing with them. I am not aware, as I said, of any counterpart which has been introduced in the House. I think Chairman Rodino has talked about such legislation.

Mr. BEDELL. The administration has proposed legislation which is being introduced by Senator Kennedy?

Mr. LITVACK. No, Mr. Chairman, the administration has not proposed legislation. Senator Kennedy has a bill pending. The Antitrust Division has commented on that, and has favored the concept and has made suggestions of its own as to the kind of legislation the division would like to see. That is where it stands now.

Mr. BEDELL. I think I misunderstood you. Has the Department proposed legislation that it thinks would help to solve this problem, or is it simply that legislation has been introduced that the Department now feels would help this?

Mr. LITVACK. Legislation has been introduced by Senator Kennedy. The division has commented on it and has articulated in some detail its own ideas as to how that might best be framed. That is where it stands.

Mr. BEDELL. And at least you believe, or the Department apparently believes, this legislation would be helpful in terms of reversing the trend that has been so well documented by Mr. Dougherty?

Mr. LITVACK. Yes; because we think it places a burden in those kinds of situations where it ought to be; namely, on the proponents, to show that the acquisition is in fact going to help competition.

Mr. BEDELL. There should be one other consideration, that is, how does it affect our society?

Mr. LITVACK. Perhaps so.

Mr. Bedell. What if it could be shown that closing a plant and moving resources elsewhere might increase competition, but it would devastate a community and displace 5,000 people? I get the impression that there is not much in present law that gives your agency the legal right to give the community and workers very much priority. Do I read that correctly?

Mr. Litvack. You read that absolutely correctly. From an antitrust standpoint, I would say that there is virtually nothing that gives that consideration much priority, as you put it. Obviously there may be, but I am just not familiar in other areas whether there are labor laws or other statutes that may have some constraints on the closing of plants. But in the antitrust context, the answer is no.

When you suggest, Mr. Chairman, that perhaps there ought to be other factors and that one, such as you have identified, considered, I would say that may well be so. What we are doing at that point, and perhaps properly so, is moving out of the strict antitrust area and attempting to deal with other areas such as the societal problem. This is one that perhaps ought to be, and indeed should be, discussed within the Congress and considered. From our narrow perspective in the antitrust world, the kind of legislation that we have suggested we think is a step in that right direction.

Mr. Bedell. Do you have suggestions, Mr. Dougherty, as to what could be done legislatively to help? I am talking about a bigger problem the movement toward more and more domination by fewer and fewer firms of our total economic activity, and the increasing difficulty of the individual entrepreneur to remain a viable sector of our economy.

Do you have suggestions for legislation that you think might reverse the current trend which you documented so clearly?

Mr. Dougherty. I do, Mr. Chairman. We endorsed the general effort behind S. 600 on the Senate side, and I will be pleased to submit to you our testimony in support of that effort, and we had our own separate legislation which we also recommended which is a little different from the legislation that was initially introduced by Senator Kennedy. I will be happy to submit that to you. It deals with the phenomenon of the very large acquisitions that are occurring, primarily the very large acquisitions.

Mr. Bedell. That will be fine. We will certainly appreciate that. [See Appendix N.]

Mr. Dougherty. As I outlined in my statement, I also believe it is a problem that goes far beyond antitrust policy as it is often narrowly defined—sometimes in my view incorrectly.

Last week in Chicago in a speech before the American Bar Association, I outlined some of the problem areas that I think should be addressed. One is capital formation. Small businesses very often do not have access to capital. There may very well be market imperfections in the capital market that result in capital being available to small businesses at very discriminatory rates. This is an area that needs a very great deal more study but it is an area where we should be directing our attention and our efforts right now. I believe the Congress should also.

Second, is tax policy. I personally agree with you in your proposal for a very progressive corporate tax. I believe 2 years ago Mr.

Folsom, then Acting Director of the Bureau of Economics at the FTC, testified before this committee and—this is all recollection—I believe that he included that on the basis of the evidence that he presented that small businesses very often pay a much larger tax rate than large businesses.

Regulation is another area. I personally endorse the concept of tiered regulation with the possible exception of the health and safety area. I do not believe that as a society we would like to see FDA relax their requirements on new drug applications just because a small business is coming forward. We have to be very careful of how we approach tiering of regulation and what sectors are tiered, but I believe, and it has been documented, that small businesses are being overwhelmed by the requirements of forms and regulation and that there is a differential cost advantage to the large businesses. We would be happy to explore with you or your staff at any time the specifics going behind those general areas of concern.

Mr. **Bedell**. You mentioned capital formation. One of the things that comes to mind is that we should lower capital gains taxes. In your testimony you have shown some of the problems that capital gains taxes cause the small entrepreneur. In fact, the capital gains tax laws encourage small business people to sell out to larger corporations.

The fact is that if we change our laws to allow enterprises to increase their capability of building capital, we may compound this problem because the big corporations are going to be the ones that gain the most capital. They are going to take that capital and expand into other lines. Thus in trying to assist the small business person raise capital, we may be doing more harm than good.

Mr. **Dougherty**. I believe from my testimony it is clear that I share your concerns. I have to caveat though by saying that I am certainly no expert in the tax area. We are only now gaining some expertise in the tax area and tax as it affects competition, that is, the capital formation area and a great deal more study and reflection and expertise has to be brought to bear on the problem.

I think it certainly has to be put right up front on the agenda. That is my personal belief.

There is one other area which I did not mention which was mentioned in my testimony. That is the idea of plant closings—there have been a number of legislative proposals made on both sides over the last several years but it just doesn't seem to be coming together and there doesn't seem to be a consensus for me as to what type of legislation might be appropriate. However, in my view there should be more coordination among Federal agencies, and among Federal and State agencies, in terms of dealing with potential plant closings. There probably should be some uniform notification requirement placed on larger firms as an example of tiering. This would be tiers of regulations and tiers of statutes. Let's say that where there is the prospect of the closing of a plant where more than 100 workers might be put out of work, perhaps some advance notification should be given by the firm to the community and to the agencies that might be able to assist the communities and other firms to avoid the unemployment consequences.

Mr. **Bedell**. Do you work with those other agencies?

Mr. Dougherty. We are working—we are negotiating with EDA of the Commerce Department now trying to effect a liaison and come up with some framework that would allow for coordination among us and hopefully permit us to come forward and say to the Congress that we think this type of arrangement is working well and perhaps should be broadened and include other agencies.

Mr. Bedell. You mentioned the Securities and Exchange Commission doing something to help small businesses form capital——

Mr. Dougherty. They have changed some of their registration requirements. That is right. I used the SEC as an example of the need for, I believe, all agencies to focus on ways in which we can unburden small businesses. SEC has taken some good action.

Mr. Bedell. Mr. Litvack, do you have any comments in regard to the suggestions Mr. Dougherty made, other than antitrust efforts, to try to see if we could move society in a healthy direction?

Mr. Litvack. The only thing I can possibly say is that when you talk about unburdening the businesses in both a regulatory and a paper sense, I think those are areas that are terribly worthwhile looking at. I think things such as Mr. Dougherty's reference to the SEC's elimination of certain registration requirements with details for small businesses are just the kind of things that we ought to be looking at.

You could get off in other areas such as tax laws, et cetera, but I must candidly confess that I am just out of my environment and I have no meaningful statement that I could make regarding those areas.

Mr. Bedell. The trouble I see is this. We compete in world markets. We need to have our steel companies competitive with Japanese steel companies. Apparently they have tended not to be—in part because they have not modernized to the same extent that Japanese steel companies have. So, we try to do something about it by changing our depreciation laws. What we find is that as they get more money, instead of improving their steel facilities, they put it into other investments. There is a tendency for large corporations to control more of our society at the expense of small business.

The problem is there is no way for us to try to get the animal to move in the direction that would be in the best interest of our Nation and of society.

We, the Congress, sit here in a position to make the laws that should help direct our society. and you, the agencies, sit in the position of trying to enforce those laws. We are asking for your suggestions as to what tools you need to accomplish your task, and I have to confess frustration. How do we go about making these changes? I understand the political pressure that exists, and I understand why I cannot get what I think would be a great improvement in our tax laws to help solve some of these problems. At least there should be some idea of what we should do to solve these problems.

Mr. Litvack. I agree, Mr. Chairman. I think some of the things that Mr. Dougherty mentioned are in the more doable category. As soon as you start talking about tax laws, I am out of my environment, and I feel you must be absolutely correct that, politically that is a separate thing unto itself. But when you start talking about the SEC and other kinds of regulatory agencies that can do something, I don't think it is going to represent, even if you do that, any dramatic change overnight in the kinds of numbers that Mr. Dougherty has cited. But it is a step in the right direction, I think. I think so too in the antitrust area. Some of the things we have suggested are a step in the right direction. They are not going to solve it overnight. This problem has been building for over 20 years. We are not going to solve it, I don't think, in 1 day. However, I think that if we start considering some of those steps and taking some of those steps, we may be on the right road and we may see at least an ebbing of that trend and perhaps a reversal over the longer haul.

Mr. Bedell. Ms. Hoppe, do you have any questions?

Ms. Hoppe. No, thank you.

Mr. Bedell. Does counsel have any questions?

Mr. Rosenberg. No, thank you.

Mr. Bedell. We want to thank you for being here this morning. I think your testimony has been helpful. I would not be completely candid if I did not tell you I feel frustrated when I see what appears to be serious problems with the direction our society is moving. I am disappointed that we are not able to come up with better answers as to what we can do.

I agree that there are things that would help, and I understand the political realities. However, the more this problem goes on, the more difficult the political realities are going to be. The more of our economy the top 200 corporations control, the more political power they will have and the more difficult it will be for the individual, the small businessman, the entrepreneur, and the small business community. I only hope that the public is aware of the problem that exists in our society. I certainly commend your agencies for whatever they can do. We pledge you our help.

Mr. Litvack. Thank you, Mr. Chairman.

Mr. Dougherty. Thank you, Mr. Chairman.

Mr. Bedell. Thank you. The meeting is adjourned.

[Whereupon at 11:55 a.m., the subcommittee adjourned to reconvene subject to call of the Chair.]

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

FRIDAY, FEBRUARY 8, 1980

House of Representatives, Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business of the Committee on Small Business,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2359, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. **Bedell.** The subcommittee will come to order.

We are continuing our hearings on conglomerate mergers and their effects on small businesses and local communities. Today we will look at various Federal agencies and their programs that offer assistance to companies and communities that have been affected by plant closings, corporate divestitures and other events related to merger activity.

Milton Stewart is the Small Business Administration's chief counsel for advocacy. As always, we expect he will be quite candid and share with us his office's views of the conglomerate merger trend, its effects, and the Government's various programs that relate to it.

We have a witness from the Department of Housing and Urban Development, Mr. Robert Duckworth. And we have several witnesses from the Department of Labor. We had originally planned to have a witness from the Commerce Department here today, but that appearance has been rescheduled for February 27.

There are several points we want to cover with today's witnesses. The first, of course, is their thoughts on the conglomerate merger wave. We are especially interested in any observations they care to make based upon specific cases their agencies have been involved with.

Second, we are interested in knowing about the programs they administer. To what extent do they target assistance to plant closings and job movements? Do they anticipate these economic traumas or do they wait for them to happen and then go in to help pick up the pieces? Do they make a conscious effort to stimulate the development and growth of the small business sector of our economy?

Finally, I personally am interested in exploring what, if any, coordination and cooperation goes on between these different agencies. In the few days we have held hearings we have heard witnesses tell of funds they received from HUD's Urban Development Action Grant program, Labor's Trade Re-Adjustment Assistance, and the Agriculture Department's Farmers Home Administration. And I am sure the SBA is involved, too. I think it is important for us to establish who is responsible for what, so we can figure out if all these programs are achieving the desired results.

Our first witness today, Lynn Cutler, is a county supervisor in Black Hawk County, Iowa. She is responsible for a very successful effort to keep open a major employer in that area, the Rath Packing Co. Black Hawk County used several different Federal programs to accomplish this, and we look forward to hearing about that experience.

Mrs. Cutler is well known and respected both in Iowa and in Washington, D.C. Her role in the successful rescue of Rath Packing is known throughout the country. It is a pleasure to welcome her here to the Small Business Committee. We are well aware of what you have done.

We have a practice here of swearing in our witnesses. Will you stand and be sworn.

Do you swear to tell the truth, the whole truth, and nothing but the truth?

Ms. CUTLER. I do.

Mr. BEDELL. You may read your testimony or you may summarize it, as you wish.

TESTIMONY OF LYNN G. CUTLER, CHAIRPERSON, BLACK HAWK COUNTY ECONOMIC DEVELOPMENT COMMITTEE, INC., BLACK HAWK COUNTY, IOWA

Ms. CUTLER. Thank you very much, Chairman Bedell.

Chairman Bedell, members of the committee, I am honored to be here today to share with you the experiences of our community when faced with a failing industry. Our response to that potential economic catastrophe, and the ensuing partnership between our local effort and the Federal Government, provides an exciting example of what I believe is possible in other towns and counties around the Nation.

I have provided you with several documents: summaries of the minutes of the early meetings of the Black Hawk County Economic Development Committee; a compilation of materials we prepared for the initial survey of the situation in our community; some press clippings about the situation which is a small example of what occurred there over the last year and a half; and the 1979 Rath Packing Co. annual report.

[See Appendix O.]

I will take a few minutes to outline to you how we responded to the crisis faced in our community. In May 1978, the workers at the Rath Packing Co. in Waterloo, Iowa, and the local community were notified by the company that the firm's financial troubles were very serious. The meat packer had experienced ups and downs for years and until that May the current downturn appeared to be a normal state of affairs. Over the past 6 years Rath had lost over $20 million.

The Black Hawk County Economic Development Committee, a delegated authority group of the Iowa Northland Regional Council of Governments, had been concerned about the situation at Rath Packing Co. for the past several years. The financial situation of the company had been identified in the county's Overall Economic Development Program (OEDP) as the most serious problem facing the local economy. With myself as committee chairperson, members of the committee, the Council of Governments, congressional representatives, and social service agencies met to discuss the impacts of the company's closing and how to prevent the closing, if possible. We wanted to have disaster plans ready and also to assess potential avenues of help.

It just occurred to us that we could not go on talking about the economic health and well-being of our community and not begin to take a more in-depth look at the situation. It appeared at any point in time the loan could be called and we looked at a 5-day closedown situation. So I convened a small group, the mayor of the city of Waterloo and several other towns in our county, the CETA director, the job service people and asked them to sit down and begin to weigh what the disaster impact would be on the community. We have all kinds of things on paper in preparation for other disasters but we had nothing in the way of an economic disaster. The Chamber of Commerce and our Congressman were with us. The first thing we did was to draw up a document which is attached which surveyed the situation. Then we began to look around at what was available to help you.

Let me tell you that Rath employs 2,179 people at its facility in Waterloo, and an additional 868 persons at other facilities in Iowa, Indiana, Texas, Florida, and California. In the Waterloo area, the annual payroll is over $32 million and the company pays local property taxes of over $500,000. Rath purchases over one-quarter of its $119 million annual hog purchases from within 50 miles of Waterloo. The average age of the Rath work force is 52 years old, and when combined with the low growth in manufacturing employment, the likelihood of employment in comparable jobs is remote. The economy would need assistance in absorbing the displaced workers, if jobs could be found for workers of that age. Our preliminary survey indicated little willingness to hire even retrained Rath workers. We said, "Should the plant go, would you hire these people," and the answer was no. It was just an unequivocal turndown.

In June 1978, Waterloo Mayor Leo Rooff, a committee member, and myself traveled to Washington to approach the Economic Development Administration and the Department of Housing and Urban Development for Federal assistance. We went over the document you have and we asked them for assistance. At that point, Senator Clark took the lead role in coordinating the Washington congressional effort.

They agreed, HUD and EDA, to jointly put together—EDA would fund, but they would jointly use a survey of the situation, hiring of a consultant firm to come in and do a crash analysis during the summer months of what was possible in the company, could it be saved and was it worth the investment of the Federal Government.

We all supported that. We obviously did not want the bringing in of massive amounts of money that would not be effective.

Both agencies were wonderful to us. I could not say enough about the help we received from these agencies.

The impacts of a Rath closing and a list of capital improvements needed by the company were outlined in a "Rath Report" prepared by the INRCOG staff. [See attachment A in the appendix O.] Officials at HUD and EDA agreed that a study of the situation was needed before the Federal Government could offer assistance and agreed to work together and share information for a solution to the impending plant closing. The interest and sympathetic ear of both agencies gave us hope.

The staff of the council of governments prepared a $60,000 technical assistance grant application to the Economic Development Administration for an analysis of the company. The grant was sponsored by the COG for the Black Hawk County Economic Development Committee. The urgency of the situation required that the study be started by July 15 and be completed by the end of August.

The technical assistance study prepared by Development Planning & Research Associates and Globe Engineering Co. reported that Rath could again become a profitable company. The solution to Rath's problems would be difficult and would require the combined effort of management, the employees, the community, and the Federal Government. The report recommended changes in management, sales and marketing, and plant operations. Many of these recommendations have been enacted.

In late September, the situation became critical as the company's principal financier could not extend additional operating capital to the company for the critical holiday sales season. The company applied for an EDA guaranteed loan, but was unable to secure lender participation. The company was forced to lay off almost 400 workers and its financial situation was becoming very dangerous. They also closed the slaughter operation at Columbus Junction—putting 260 people out of work.

Due to the seriousness and urgency of the situation the Economic Development Administration suggested, on Friday, September 29, that the community apply for a Title IX grant through a nonprofit corporation. During the longest weekend of my life, we put together an incorporation of that community and we made sure it was fully representative of the entire community, business, labor, the minority community, the handicapped interests, there literally is not an element of our community not represented.

We were incorporated by Monday. I was elected as the President and directed legal counsel to prepare articles of incorporation and to finalize the incorporation by the end of the week to enable the committee to apply for the Title IX grant. The next day INRCOG economic development planner, James Thele, met with EDA officials at the Denver regional office and by Friday the Title IX application was completed and on its way to Washington. The grant was approved on October 11, 1978. I flew to Washington, signed the forms, and flew home with the check in my possession. The funds were loaned to the company on October 16. Again I cannot underscore enough how helpful the people at the EDA were to us in their assistance to us.

The $3 million Title IX grant was made to the committee with the stipulation that it be used for short-term assistance to the Rath Packing Co. The interest from the loan to Rath is being used to prepare a long-term financial plan for the company and to prepare an alternative economic adjustment strategy for use in the event that a long-term solution to Rath's problems does not work out. It is also being used for other economic development activities in Black Hawk County and the six-county region through a revolving loan fund plan that is being finalized. The committee entered into a contract with the council of governments for staff to prepare the plans.

Since the grant was received in October 1978, our committee has been working with management and labor in monitoring the company's progress on an almost weekly basis. We have been in very close communication and are deeply involved in all of it.

As part of our overall strategy to assist Rath, the city of Waterloo prepared an urban development action grant for capital improvements at the slaughter and processing plant. In September 1979, the Department of Housing and Urban Development announced the awarding of an urban development action grant of $4.6 million to the city of Waterloo. This grant is predicated on a successful vote of the stockholders to allow the sale of 2 million shares of Rath stock at $2 par value to the employees of the company. The private leverage for the UDAG comes totally from the employees—in a combination of deferred benefits—including paid holidays, vacations, and sick leaves—and cost of living increases currently accumulating in an escrow account for working capital.

The proposed employee stock purchase is currently at the Securities and Exchange Commission for final approval.

The UDAG will be coordinated with the EDA loan by the Black Hawk County Economic Development Committee. The committee will continue to monitor both loans and will maintain an active community role in the future of the company.

When all of the money is repaid, our county and all surrounding counties will have $7.6 million plus the interest paid for economic development activities.

We will also have a viable, healthy, pork producing plant—Rath has announced a profit of $1,006,000 for the fourth quarter of fiscal year 1979—fiscal year September 29 to October 1, and $1,701,000 profit for the first quarter of 1980. Contrast these figures with the fourth quarter of fiscal year 1978 loss of $2,496,000, as compared to the loss of $1,094,000 for the first quarter of fiscal year 1979.

We are not out of the woods yet, but a wonderful coordinated effort between our community, assisted by former Senator Dick Clark and the tremendous attention and assistance from Senator John Culver, with exceptional cooperation from the White House, Bob Hall, Bob Embry, and their people make it a possibility.

Finally, I must speak to the unusual effort by the employees of the company. It is their dollar, their willingness to save their own company and to purchase controlling interest in it through a unique employee stock purchase plan that will ultimately make the difference.

I have tried to cover an incredible amount of time and almost daily effort in a few moments, Mr. Chairman. I have not even touched on the day-to-day crises or the joy of reopening Columbus Junction, hiring back 400 people and adding new employees, and an additional shift—pension payment deferrals, State action, lawsuits—there has just been one major or minor crisis one after another—all have threatened our efforts. But we are still there, doing better and on our way to success. We are grateful to the Carter administration for timely, sensitive response to a potential tragedy and for the philosophy that created programs like those that have helped us. We are grateful as well to the Congress for enacting them.

I am ready for questions.

Mr. **Bedell.** Thank you very much, Ms. Cutler.

I do not exactly understand. Did Rath sell the plant and business to the employees? What happened with Rath, they were operating a business that was losing money, and there were indications they were going to close the plant. What is their situation today?

Ms. **Cutler.** Company ownership is still the same. The employee stock purchase and takeover has not yet been effected. We are still waiting for final approval from SEC of the prospectus. But the EDA money coming at the time it did enabled the company to purchase raw product to make the marketing and sales changes, to do the management changes that were recommended in the original consultant study.

They went to a regional sales operation, for example. It was determined that a national sales organization did not make sense. They went to the use of sales representatives in many areas. There were many changes in promotion.

Additionally, we were lucky in that we came in at the right end of the hog cycle. Hogs became cheaper and more plentiful, which was very helpful as well. But the point at which the EDA money came into the system, they were really facing a threat by Talcott, the major lender. They were not going to extend credit at that time.

There are still very serious problems.

Mr. **Bedell.** Does Rath have other plants and other interests besides the Waterloo plant?

Ms. **Cutler.** It has other plants, but not other interests. It is a privately held corporation. It is not a part of a conglomerate. I discussed this with staff in terms of what your interests are.

There is a facility in Indianapolis, one in Los Angeles, one in Texas other locations and then of course the slaughter operation in Columbus Junction, Iowa. The entire structure was threatened. There seemed to be some certainty that Waterloo would certainly be closed, even if they were able to put the rest of it together into a functioning company. There also seemed to be a great willingness on their part to close the Waterloo facility and work with the others, which we did not share.

Mr. **Bedell.** They were grants rather than loans?

Ms. **Cutler.** The grant was made to my committee, a private nonprofit corporation, and we in turn loaned it to the company.

Mr. **Bedell.** If the employee stock ownership proposal is not approved by the SEC, then the money will have been loaned to

Rath by your corporation, and if they make a go of it, then you have saved the situation in Waterloo. If they do not, your corporation just go out of business?

Ms. CUTLER. No; I do not think the corporation will go out of business. We existed as a committee before this situation. But what is the contingency part of it is the UDAG grant which will not become finalized until there is a successful vote by the stockholders. The UDAG is contingent upon that. The EDA loan is there, not permanently yet——

Mr. BEDELL. Is it a loan or a grant?

Ms. CUTLER. It is an EDA grant to the committee.

Mr. BEDELL. The $3 million you stuffed in your pocket and flew back to Waterloo?

Ms. CUTLER. Chained to my wrist.

The grant is there for the committee, but we are still on a 90-day cycle. Every 90 days the EDA authorizes the committee to lend to the company. We have kept them further on a 30-day tether. They have to report to our committee every 30 days in depth on the current situation. A determination is made by the committee every 30 days to relend the money. We are literally putting it in on a monthly basis, within a 90-day time frame from EDA. All this is being done to make sure the company continues to comply with the recommendation made by the original consultants, as well as waiting for this final long-term package to be put together. The big piece in that long-term package that is still waiting is that UDAG grant again triggered by the vote of the stockholder. Once that final piece is in place, the two agencies together approve long-term economic strategy for the community and the money then is under total control of the local community.

Mr. BEDELL. Who hired the consultants for the study?

Ms. CUTLER. Our committee did. The original $60,000 EDA technical assistance grant was to our committee.

Mr. BEDELL. And that was for the study?

Ms. CUTLER. That is right.

Mr. BEDELL. You indicated in your testimony that one of the people you had worked with was a Bob Hall of EDA.

Ms. CUTLER. Yes.

Mr. BEDELL. Accusations were made against Mr. Hall in an earlier hearing of this subcommittee by witnesses from Youngstown, Ohio, about the way he handled a matter similar to the one in Waterloo.

Ms. CUTLER. I do not share that experience at all. Mr. Hall and his people, Hal Williams, the people out in the Denver regional office, were wonderful. I have worked a lot with Federal agencies over the years, and I have never encountered the really creative willingness that they expressed in this situation.

Mr. BEDELL. They were most cooperative?

Ms. CUTLER. Yes, sir.

Mr. BEDELL. If the ESOP is approved, is the $4 million that comes to it actual cash that will be paid by the employees? So they have to give up wage increases or vacation time?

Ms. CUTLER. There are two pieces to it. The cost-of-living increases are actually being deferred for working capital. Stock purchase dollars will be deducted after the vote.

Mr. **Bedell**. In other words, Rath is putting that into a separate account?

Ms. **Cutler**. The deferred benefits package, the vacation money, et cetera, is working to keep things in a healthy situation. I did not go into any detail about these. The employees themselves are not going to own that stock. It will be owned by a voting trust that will be controlled by the employees. The stock will stay in perpetuity. As an employee dies or retires, the stock will be purchased by the voting trust, will not go back out into general ownership.

Mr. **Bedell**. What percent of the company will the employees own?

Ms. **Cutler**. It will be over 50 percent. Stock is widely held now. The largest block we are aware of is less than 5 percent. The $2 million we are talking about going before the vote of the stockholders is more than is generally held now, elsewhere.

Mr. **Bedell**. So they will own over half the company?

Ms. **Cutler**. That is right.

Mr. **Bedell**. Then the trust will have control of the company; is that correct?

Ms. **Cutler**. Yes; and there will be employee representatives on the board of directors.

Mr. **Bedell**. There are some tax advantages for an ESOP trust. The money paid into it is pretax money if the company is profitable.

Ms. **Cutler**. The EDA money has been used to purchase raw product, to make the sales and marketing changes we discussed and strictly for capital and management kinds of activities. The UDAG money is earmarked specifically for the fiscal changes, the changes in the canning operation and some of the other things outlined there.

Mr. **Bedell**. The money that has been given to your corporation, then loaned back to the company, why is that a grant rather than a loan? If it is Federal money that is going to make this come about, it seems more reasonable that it should be paid back to the taxpayers rather than your organization.

Ms. **Cutler**. I do not know the law well enough to tell you whether there is foundation in the law for that, but I do know that was the decision of EDA, that the feeling was there was such a strong unified effort in the local community, and that the money is going to be there for such a long period of time, it should be there to be able to be continued for development activities. As I have said, we are using the interest now to set up a mini-SBA in our committee for economic developments in our community. The long-range impact is there. If it is paid back to the Government, it does not go back to the Economic Development Administration or the Commerce Department, it goes into the general fund. You might make an argument this is a good way to go. But the dollars are there in the community. In the event something should happen to the company, we would have the interest rate and whatever repayments have been made to help in economic adjustment activities; that was the decision of the Economic Development Administration, and of course we like it.

Mr. **Bedell**. We are trying in this subcommittee to look at the problems, if there are such problems in communities as a result of corporate mergers and divestitures. We have tried very hard to get people to come before the subcommittee and discuss instances where such conglomerate mergers have been successful and helped communities. I believe there are such cases, but we have not been able to get any witnesses to testify in regard to that sort of situation. That is one of the reasons we are glad to have you here. This is an example where a catastrophe was averted, primarily because of your initiative with the other people in the community, and with the cooperation of the Government.

Ms. **Cutler**. There is no question. It was a full partnership from the very beginning between the local governments and the Federal effort.

Mr. **Bedell**. It is quite refreshing to have you tell us good news instead of the bad news we usually hear.

Does the staff have any questions?

Mr. **Rosenberg**. No, thank you.

Mr. **Bedell**. Ms. Hoppe.

Ms. **Hoppe**. No questions.

Mr. **Bedell**. Our next witness is Milt Stewart, Chief Counsel for Advocacy, Small Business Administration. He shares his time between the SBA and the small business community.

Will you stand to be sworn?

Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Stewart**. Yes.

Mr. **Bedell**. We are glad to welcome you, and I am sure you are aware of the admiration we have of your work.

TESTIMONY OF MILTON D. STEWART, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. **Stewart**. It is always a pleasure to come here, Mr. Chairman.

I would like to begin this morning by asking permission to have my statement appear in the record and to amend it as it may become necessary.

If I may, I would like to read one of the recommendations of the recent White House Conference on Small Business which for the first time in our country's history brought to this city 2,000 small business entrepreneurs from every part of the country who had talked over matters of concern. One of the recommendations which they made to the President and the Congress was that the merger and acquisition antitrust laws should be amended to inhibit the growth of conglomerates; to provide safeguards built in to protect the distributors, dealers, and franchisees; and to prevent the termination or nonrenewal of wholesalers and franchisees without good legal cause.

I have not checked specifically, but it is my impression that this is about the only place among the 60 recommendations made in which the delegates asked for more affirmative regulatory Federal action.

Everyplace else they asked for less, for a diminution of the Federal role in the economy or at best a redirection of it. Here, in effect, they expressly ask for a strengthening of Federal law and regulation.

I would like also, Mr. Chairman, to mention that I suspect that is a recommendation to some extent because of the leadership and the effort of a man whose absence I feel very strongly this morning, my successor, the president of the NSBA, who died this week, John Lewis, and who for many years along with a few of us led the fight to the kind of balanced economy I am committed.

The statement I have given you is general. The additional comments I would like to make to explain its background are even more general. I hope in the months ahead to be able to furnish you with some specifics. We have underway some data collection and clarification which I hope will provide this committee and the rest of the Congress with a clearer sense than we yet have about the relative position in the economy of small business, large business, and the Government.

What I have tried to say in this statement is, in a way, that the 1980's, in which this conference began so auspiciously for small business, will either be the catchup decade for small business, which is what John Lewis and I started to hope for 5 years ago, or it will see an acceleration of the shrinkage of the small business sector in favor of large-scale enterprise and/or the Government.

The policy issue that we ought to be talking about when we talk about conglomerate mergers is broader than merger and antitrust policy itself, although they are close to its heart. The question is what kind of an economy do we want and what kind of public policies do we have to have to get it. In my own view, we presently have a nonpolicy. We have pieces of two leftover policies whose roots are in the late 19th century. One comes from the antitrust laws, generally misunderstood in our country by small business particularly and by the public in general, and the policy which derived from congressional pressures in the 1930's to take affirmative action to expand the small business sector reflected by the SBA's activity, Small Business Investment Act, and things like that.

Those two pieces of leftover policy have never been put together in an affirmative national policy commitment to the expansion of the small business sector and the common control of the size of the Government and the size of government-size business. It is that need, it seems to me, that this committee, the Judiciary Committee, the Ways and Means Committee, the Science and Technology Committee, must all begin to address together if we are to make sense of conglomerate mergers and the other issues bound up with them.

It is my hope that the small business sector will be expanded. The data we have so far indicate it is not only not expanding, but has probably lost ground during the 1960's and the 1970's relative to large business and Government. It is my hope that we can see the Congress and the executive branch join in a 10-year effort to achieve compensatory growth in the small business sector and that that will be characterized not only by the kind of improved regulation of conglomerate mergers but also by revision in tax policies which keep small business from being attractive for investment as big business and make municipals more attractive than big business, by regulatory policies which acknowledge the relevance of our traditional commitment to progressivity of burden and result in two-tier regulation, by procurement policies which mend the scandalous underfunding of small business by Federal research and development, capital and credit policies which allow the expansion of equity capital and long-term debt in banks and large financial corporations which are more and more concentrating outside the small business sector.

To get there we have to get at facts which are in dispute, facts about the relative growth of large and small business in the private sector and the Government.

I think we will have data for you within several months which will be unquestionable and which will make clear the urgency of the problem before us.

We also have a serious problem in getting a rational national discussion of this problem. The issue turns now on a misstated burden-of-proof question stated in effect by the opponents of corporate merger restriction.

I try in the statement to deal with some of their assertions as best I can, briefly, I will try to do more of it but the burden of proof it seems to me is not where it ought to be. Again and again they say, "Aren't there good mergers? Are all mergers bad? Is the cure worse than the evil?"

It seems to me the burden has to be put one pace back and it has to be put on them.

If we do not today confront excessive concentration, with 300,000 companies sharing the 20 percent of the economy, if that is not excessive concentration, when will the opponents of merger legislation concede that it is? Do we have to wait until we are down to 15 percent, 10 percent, 5 percent, no percent? Eighty percent of this Nation's manufacturing assets are presently controlled by 500 corporations. Do we have to wait until the 500 companies become 200, 100, 50? The burden is on every chairman of the board of every major company which presumes to oppose this legislation to come forward and say to the Congress and people of this country, "We will support merger legislation at X point in the pattern." Unless they are prepared to say that, as far as I am concerned they forego the right to take part in orderly discussion because they refuse to acknowledge the possibility as reasonable that we must reach a point where this legislation or something like it will be necessary.

I am talking about the proposal by the FTC to limit mergers and acquisitions by companies which have $2 billion in sales or assets.

The ultimate justification for this legislation is not economic alone; it is not the preservation of competition alone. It has to do with the most fundamental rights in this country, it has to do with the right of people to start businesses and have those businesses grow competitively. All those rights are seriously affected by conglomeration. We need a two-dimensional policy, one to expand small business operation and an affirmative policy that there is a point where a business stops being just a business and stops just being a device for asset management but begins to take on the characteristics of government. It is at that point that the public government of us all has not just a right, but an obligation to step forward in the interest of all of us.

Thank you, Mr. Chairman.

[Mr. Stewart's prepared statement with attachment follows:]

Prepared Statement of Milton D. Stewart, Chief Counsel for Advocacy, Small Business Administration

Mr. Chairman. Thank you for inviting me to appear before your Subcommittee. This issue of conglomerate mergers is one that is important to me personally and those people I represent—the small business community. My statement will be short but I will be happy to answer any questions you may have.

I must stress that the views which I am expressing on this subject are my own and are not necessarily those of the Administration or the Small Business Administration.

The issue of the role conglomerate mergers should play in our Nation's economy was the subject of hearings held by the Office of Advocacy in Syracuse, New York in November and December of 1978. About 40 persons appeared at the hearings to voice their concern regarding the proposed takeover of Carrier Corporation by United Technologies Corporation and its impact on the Syracuse area. All but one of the 35 small business people opposed the proposed acquisition or conglomerate mergers in general. A brief summary of those hearings is attached as Appendix I to my statement.

Legislation is required to alleviate the increasing dominance of what we call "government-sized businesses." A "government-sized business" is one in which assets, sales or number of employees is large enough to put it in a league with the average State government. In fact, 21 States have total revenues under the $2 billion average of sales and assets suggested by the FTC staff as a proper point at which the law regarding mergers and acquisitions should change; 27 States have revenues less than the $2.5 billion suggested by others as a break-point for "government-sized business."

These "government-sized businesses" have the capability to administer prices and negotiate for capital. That power is roughly equivalent to the Government's power to tax in its potential to destroy or disrupt. The economic welfare of countless communities, such as Syracuse, is subject to the control of far-flung conglomerate enterprises.

Traditional antitrust laws do not adequately address the problem of conglomerate mergers and the government has not been able to stem the tide of corporate mergers through their use. This is one of many instances where application of the same standards to both large and small firms discriminates against the smaller firms. Thus, a two-tiered approach to antitrust enforcement is required to equalize the burdens on large and small businesses. The proposed legislation solves the problem by taking "government-sized businesses" out of the merger arena.

Opponents of anti-merger legislation argue that mergers improve the quality of management. In other words, capital investment will flow from a poorly-managed business to a well-managed one. In fact, just the opposite occurs. According to professionals who search for ongoing businesses to acquire, acquiring businesses seek healthy companies to take over. One such arbitrageur stated in Business Week in 1977 that he specifically looks for companies that are earning at least 12 percent on capital and whose markets are growing by 10 percent a year. He is willing to pay up to 15 times earnings and expects to get a 12 percent annual return on investment after taxes and charges for goodwill. According to the SEC, firms rarely list bad management of the acquired firm as a reason for a takeover or merger. In fact, SEC listings usually state that the acquired firm is well run and that the management of the acquired firm will remain.

Closely allied to the argument that mergers serve capital investment better is the "economy of scale" justification for the concentration of economic assets. Although this philosophy may have been valid to a point, the large conglomerates of today no longer merge for this reason. For example, studies show that in the steel industry economies of scale are reached by a company which controls 1.7 percent of the market but each of the largest steel producers has approximately 11 percent of the market share. Economic studies demonstrate that after some point there is a "diseconomy of scale." As a conglomerate continues to grow, internal communication becomes more complex and quick reactions to changes in the business world become more difficult.

John Shenfield, Acting Associate Attorney General, believes some mergers are no longer based on expected efficiencies but simply reflect financial attractiveness, a way to invest surplus cash rather than to distribute to stockholders and to reap certain tax benefits.

Also, we cannot lose sight of the fact that economies of scale are important in production, not management. If two diversified companies belong to the same parent, their individual products will not share a joint assembly line to produce goods more quickly and cheaply. The only consolidation will be in management, financial, and advertising capabilities—areas that could lead to unfair competition.

A company which is a subsidiary of a "government-sized business" and equal in size to an independent firm will not gain a large share of the market because of production efficiencies but because of larger advertising budgets and ready access to capital.

A clear example of the breakdown of the argument about better management and economies of scale for conglomerates is the current Chrysler Corporation financial crisis. Where is the efficiency of management that should arise in a corporation that is number 26 in the Fortune 500? As one writer said, a corporation can go "down the wrong road just as efficiently" as it can go down the right road. When there are huge conglomerates there occurs a "loss of feedback," resulting from a too-centralized decision-making process. The input from diverse parts is missing and economy of scale becomes an easier path to a bad decision.

Opponents of this legislation raise the specter of its being detrimental to small businesses by eliminating an entrepreneur's "right to exit." This rationale is specious. This bill does not prohibit all mergers but only conglomerate mergers between large sized businesses. The proposed legislation does not tell companies that they cannot merge, but only that they cannot merge with certain conglomerates. In fact, the National Small Business Association, the National Federation of Independent Business and the Small Business Legislative Council have all testified in favor of limiting conglomerate mergers. NFIB polled its members and found that two-thirds of them opposed conglomerate mergers.

One of the proposed justifications for allowing conglomerate mergers is the necessity for raising capital. In a study conducted under the auspices of the Small Business Administration, it was found that only 7 percent of acquired firms are motivated to sell to an acquiring firm by lack of capital. Tax consequences of holding onto a family business and plans for retirement are seen as more significant reasons.

Secondly, the mergers that the pending legislation seeks to prohibit are not between marginal companies that cannot obtain financing. The firms this bill addresses are large and successful; they have established lines of credit and financial relationships that allow them to get the capital they need. As stated before, times have changed. Unlike the earlier mergers where a large corporation took over a financially fragile small business, large conglomerates are now only looking to prosperous, on-going concerns. In light of the evidence that only successful businesses are the targets of corporate takeovers, opponents of this legislation would be hard pressed to show that entrepreneurs going into business rely on the knowledge that if their business fails, there is a ready buyer. Studies show that there is a ready conglomerate buyer only if there is a successful business.

Lastly, I address the argument that if we prohibit "government-sized businesses" from merging, we can no longer compete in the international marketplace. Opponents glibly cite those nations where the government "merges" with companies to create a world-wide corporate power. This analysis overlooks two things—(1) bigger is better only until the peak economy of scale is reached and, as I have stated earlier, much of American industry has reached, and surpassed, that point and (2) smaller and medium sized firms, especially in high technology areas, compete very well in international markets.

Now let us turn to consider the reasons why the proposed legislation is necessary. The Clayton Act has simply been inadequate in the task of preventing waves of merger activity. The Department of Justice and the Federal Trade Commission have been unsuccessful in their attempts to bar potentially anticompetitive mergers by the Supreme Court's application of stringent legal standards. Between 1964 and 1977, the Department of Justice won 11 conglomerate cases, and lost 22, with 12 of these losses occurring since 1974. Thus, the proposed legislation would provide the only effective mechanism to halt these larger mergers.

Conglomerate activity concentrates too much political and social influence in the hands of large businesses. The conglomerates' extensive nationwide network of employees and suppliers allows these firms considerable access to federal, state and local governments. Chairman Michael Pertschuk of the FTC cited an example of the pervasiveness of this political influence: "ITT's effort to acquire ABC in 1968, though ultimately aborted, found 300 congressmen and senators protesting the antitrust division's opposition to the merger. Can there be any doubt that this collective show of political concern be traced, at least in part, to ITT's 265 subsidiary corporations, its 200,000 shareholders and 400,000 employees, and the spread of ITT operations to every state of the Union?" The Office of Advocacy, in its Syracuse hearings in late 1978, documented the problem of the corporate giant wielding tremendous influence over the economic welfare of many areas of the country. Local communities are subject to decisions made by executives at distant corporate headquarters who are little concerned or knowledgeable of local problems and needs.

Corporate merger activity also does not not bode well for the Nation's future employment prospects. Historically, small firms have contributed virtually all net new jobs in the private sector. The cash or securities used by corporations in acquiring already established firms could be better utilized for the generation of new jobs through internal expansion of the corporation.

Technological progress is also being impeded by the growth of these huge conglomerates. Innovative managers from the acquired corporations often depart from the conglomerate to seek more challenging employment. Studies have demonstrated a negative correlation between corporate size and innovation. According to a study conducted by the National Science Foundation, in the period between 1953 and 1973, small firms produced about 23 times as many major innovations per R&D dollar spent as large firms, and nearly 4 times as many per R&D dollar as medium firms.

Lastly, conglomerates threaten free competition in the marketplace. These firms, through cross-subsidies and reciprocal agreements between subsidiaries, facilitate the acquisition of monopoly power by the subsidiaries. The ability of these conglomerates to discipline their smaller competitors intimidates others from expanding or entering in a competing line of business. Free competition would be better served by "toe-hold" entry or expansion within its own markets, rather than acquiring a firm with a substantial market share.

The time for discourse is over. We can no longer tolerate any further diminution in this Nation's economic diversity. The continued increase in "government-sized businesses" raises a serious threat to our political and social institutions. It is essential that Congress act speedily to enact legislation that will reasonably limit the heretofore unchecked growth of conglomerate mergers.

Appendix I.—The Impact of Major Mergers on Small Businesses

Small Businessmen

Mr. Douglas Johnson, president, Barlow Johnson (advertising agency), Syracuse, N.Y., November 2, 1978.—Mr Johnson testified that on the basis of some twenty past experiences through his offices in Albany, Buffalo, and Springfield, Massachusetts as well as his Syracuse office, both his own firm, as well as many of his clients who like his firm either service or supply Carrier, would ultimately lose massive or significant amounts of business as a result of the United Technologies takeover.

Mr. Theodore Pierson, chairman of the board, Onondaga Supply Co. (industrial supplier), Syracuse, N.Y., November 2, 1978.—Mr. Pierson testified and documented that merger mania was on the loose in upstate New York, stressed his belief that a company has a right to be protected against "hostile takeovers", and offered evidence as to the allegedly deliberate misleadings of UTC pro-merger advertisements.

Mr. Herbert Roach, vice president, Basler Electric Co. (independent manufacturer of transformers and electrical control devices, 950 employees), Highland, Ill., November 2, 1978.—Mr. Roach testified of what he described as a widely-shared fear among his peers that small and medium-sized firms will soon be, if the present merger trend is allowed to continue, squeezed almost totally out of the competitive picture, with the ultimate victim of this mounting concentration being the free enterprise system itself. Mr. Roach offered case histories of mergers resulting in lost business to his firm, business lost frequently to inferior products at non-competitive prices.

Mr. Carlton Tupper, owner and operator, Highgrade Metals Products Corp. (15 employees), Syracuse, N.Y., November 2, 1978.—Mr. Tupper testified of his firm losing work as a direct result of two recent, local mergers, work lost to firms located close by to the central purchasing headquarters of the merging firms.

Mr. Raymond Cummings, president, Industrial Fabricating Corp. (steel fabricating, 60 employees), E. Syracuse, N.Y., November 2, 1978.—Mr. Cummings testified that it might be wise to consider the posting of a bond equal to 5% of a merger's purchase price with the merged firm's community to ensure that promises, made and historically broken frequently by the merging firms, are kept.

Mr. Jack Estabrook, owner, Estabrook Printing (offset printer, 44 employees), Syracuse, N.Y., November 2, 1978.—Mr. Estabrook testified that when mergers occur, according to his own experiences, central purchasing (whether it be district, regional, divisional or whatever) takes over because the desire for larger profits dictates volume buying.

Mr. Robert Robischon, owner and manager, Syracuse Industrial Sales Co., Ltd (resale business of construction maintenance equipment and industrial tools and supplies), Syracuse, N.Y., November 2, 1978.—Mr. Robischon testified to (and documented in great detail) his belief that bigger is not better and that mergers invariably work to squeeze out small businesses either by slashing their profit margins or eliminating their contracts altogether.

Mr. Bernard Dvorsky, president, Bernard's Contemporary and Bernard's Business (interiors, 40 employees), Syracuse, N.Y., November 2, 1978.—Mr. Dvorsky testified that Carrier was 25% of his business and that he feared the likelihood and impact of central purchasing by UTC.

Mr. Terry Galanis, president, Sealing Devices, Inc. (50 employees) Lancaster, N.Y., November 2, 1978.—Mr. Galanis testified about Buffalo—area firms, that once taken over, were shut down and ultimately relocated in other states.

Mr. Robert Small, president, Smith & Caffrey Steel Corp. (steel fabrication, 70 employees), Liverpool, N.Y., November 2, 1978.—Mr. Small testified and documented that just as Carrier "carried" and made them, losing their business could break them.

Mr. James Higbee, president, Higbee Rubber Co. (25 employees), Syracuse, N.Y., November 2, 1978.—Mr. Higbee testified that much like slaughter of buffalo precipitated the vanishing or diminishing of the American Indian, mergers are systematically eliminating small businesses from the United States business community.

Mr. Michael Alibrandi, vice president, JGA Construction Co. (general contractor), Syracuse, N.Y., November 2, 1978.—Mr. Alibrandi testified that without Carrier's local building program over the years, the local construction industry would be substantially more decimated than it is today.

Mr. Ralph Moreland, president, Moreland & Sons Signs (4 employees), Syracuse, N.Y., November 2, 1978.—Mr. Moreland testified that although Carrier's business was now 20 percent of Moreland's total, in the past Carrier had gotten Moreland started and kept it alive. Mr. Moreland also stated that as a minority firm, he appreciated Carrier's fair approach in contrast to his dealings or attempted dealings with other large corporations.

Mr. Donald Lamprey, vice president, Mid-State Elevator Co. (45 employees), Syracuse, N.Y., November 2, 1978.—Mr. Lamprey testified that based on his knowledge of past business practices of Otis Elevator, a UTC subsidiary, he feared that UTC's takeover of Carrier would not only lose him his Carrier business but set up a situation whereby through Otis and Carrier, UTC would dominate contracts let by many local office buildings.

Mr. Ronald Woodcock, R. L. Woodcock & Associates, Inc. (mechanical contractors, 50 employees), Syracuse, N.Y., November 2, 1978.—Mr. Woodcock testified as to personal knowledge of how ITT took over a local company and subsequently the merged firm's R&D capacity, product quality and overall marketability had declined substantially.

Mr. Jake Berdan, president, Edro Business Forms, Syracuse, N.Y., November 2, 1978.—Mr. Berdan testified of his fears that not only would he lose his 20 percent of contracts accounted for by Carrier, but that since he and Carrier shared many significant clients, to the extent that UTC goes to central purchasing, he'll be near destroyed. Mr. Berdan noted that in the present uncertainty, he can't sensibly make needed equipment purchasing decisions.

Mr. Charles Meister, president, Jardine Bronze & Aluminum Foundry (55 employees), Baldwinsville, N.Y., November 2, 1978.—Mr. Meister testified that from personal experiences, both in his present capacity and as a former employee of Standard Oil of New Jersey, mergers inevitably result in corporate centralization, in purchasing as well as in other areas.

Mr. John Hayes, Jr., president, MacAlaster Bicknell Co. of New York (laboratory equipment and supply distributor), Syracuse, N.Y., November 2, 1978.—Mr. Hayes testified as to how a merged firm's large purchases must be cleared centrally with the frequent result that the purchase is not made locally, but centrally, to the local supplier's detriment.

Mr. Willie Nash, president, Nash Machine Co., Inc. (job shop, 15 employees), Syracuse, N.Y., November 2, 1978.—Mr. Nash testified that he and other job shop owners would be wiped out by understandable, but nonetheless devastating central purchasing of machine parts, if UTC bought Carrier. He noted that he was speaking for approximately thirty different job shops who individually employed between five and fifty employees apiece.

Mr. Robert Stevens, general manager, Selflex Siren Product Co. (25 employees), E. Syracuse, N.Y., November 2, 1978.—Mr. Stevens testified that if he lost Carrier's business, he would have to lay off seven people and that, in the meantime, he would have to postpone making any capital expenditures.

Mr. John Quinlivan, partner, Quinlivan, Pievik & Krause (architects and engineers, 35 employees), Syracuse, N.Y., November 2, 1978.—Mr. Quinlivan testified of his fears of various possible centralizations of previously locally-exercised decision making authority.

Mr. Leonard Krenna, president, Syracuse Fasteners (10 employees), E. Syracuse, N.Y., November 2, 1978.—Mr. Krenna testified that his informal inquiries revealed that unlike Carrier, UTC treated its suppliers rough and impersonally. He feared that losing Carrier's business (35% of his overall business) would end up wiping him out.

Mr. Clarence Weiler, president, Screen Graphic Arts (decal manufacturer, 15 employees), Syracuse, N.Y., November 2, 1978.—Mr. Weiler testified of the negative impact locally of past mergers and subsequent pull-outs and speculated that central purchasing by UTC could hurt his business terribly.

Mr. Harris Cooper, president, Cooper Decoration Co., Syracuse, N.Y., November 2, 1978.—Mr. Cooper testified that his small firm was Carrier-dependent and that he feared negative consequences of a take-over.

Mr. Philip Braunshweig, executive, Chamberlin Rubber Co., Syracuse, N.Y., November 2, 1978.—Mr. Braunshweig testified, from personal experiences both in his present position as well as a former employee of Stromberg-Carlson when it was taken over by General Dynamics, of the negative consequences of mergers.

Mr. Steven Furcinito, partner, Furcinito Construction Co. (homebuilders), Liverpool, N.Y., November 2, 1978.—Mr. Furcinito testified that he built homes aimed at the middle-income, white collar Carrier executive bracket, a bracket he felt would be significantly depleted by the UTC takeover. He noted that actual surveys revealed that he and his competitors sell 25 percent of their homes to manufacturing executives.

Mr. Dan Greeson, president, Hurbson Office Equipment Co., Syracuse, N.Y., November 2, 1978.—Mr. Greenson testified as to the feared negative local impacts of UTC central purchasing.

Mr. Warren Freed, president, Mahoning Culver (35 employees), Canfield, Ohio, December 1, 1978.—Mr. Freed testified that it took only seven years for some steamboat captains from New Orleans that don't know anything about running a steel company, to wash down the tubes what it took seventy years to build. Mr. Freed was referring to the aftermath of Lykes 1969 takeover of the Youngstown, Ohio Sheet and Tube Company which he felt affected negatively the Youngstown area small business community.

Mr. Irving Strogatz, owner, Howard's Shoe Store, Torrington, Conn., December 1, 1978.—Mr. Strogatz testified on the various impacts of Ingersoll-Rand's 1969 takeover of the Torrington Company. His analysis indicated that Ingersoll-Rand employment growth was occurring in the South, but not in Torrington. He stated that even the noblest takeover will inflict some sociological hurt.

Mr. Paul Spaulding, owner, Spaulding Associates (consulting engineers, 175 employees), Syracuse, N.Y., December 1, 1978.—Mr. Spaulding testified that he had business with both Carrier and UTC, that Carrier's "hands were by no means clean", and that he believed that the merger would be good for Syracuse.

Mr. David Schuler, president, Erie Industrial Sales (industrial distributors, 100 employees), Erie, Pa., December 1, 1978.—Mr. Schuler testified on a great variety of mergers, some of which produced no noticeable negatives, many of which accelerated the trend toward central purchasing with negative results for "local small business". Mr. Schuler noted that central purchasing rarely saves money, but inherently consolidates power with, in his opinion, much the same corruptive potential that occurs due to centralizing government power.

Mr. F. X. Matt II, vice president, West End Brewing Co., (300 employees), Utica, N.Y., December 1, 1978.—Mr. Matt testified against conglomerate mergers especially when they are opposed by the smaller company. He cited the socially desirable limitation on small business which tend to prevent them from doing bad things that they might want to do: namely, they are limited in their ability to raise prices, to eliminate competitors and prevent new ones from entering the field, and being dependent on community goodwill, small businesses tend to avoid arbitrary actions tha will injure their community.

Small businessmen/Chamber of Commerce leaders

Mr. David Weatherup, owner (chairman, Syracuse Chamber of Commerce Small Business Council), Central Fence Co., Syracuse, N.Y., November 2, 1978.—Mr. Weatherup testified as to whether merger-induced economic concentration will stifle the competitive spirit which sparks the free enterprise system, whether it will dampen the creativity and inventive genius of the young Willis Carriers and Tom Edisons of our day who experimented in their back garages and machine shops?

Mr. Philip Anderson, president (legislative chairman, Syracuse Chamber of Commerce Small Business Council), Anderson Metals Syracuse, N.Y., November 2, 1978.—Mr. Anderson testified that the Council estimated that between 70 and 90 small businesses would go out of business if purchasing was to be centralized or disrupted substantially by a shift to Hartford, Conn.; that they had identified 42 companies who are over 90 percent Carrier Air-Conditioning (dependent), and an additional 40 who are over 50 percent Carrier; and we believe that if a company does as much as 30 percent (of their business) with Carrier, and if purchasing was substantially altered, it would have a substantial effect on the companies' chances of staying in existence, and they would have to question whether or not they should continue to function.

Chamber of Commerce officials

Mr. Alex Baker, executive vice president, (Alabama Chamber of Commerce), Bessemer, Ala., December 1, 1978.—Mr. Baker testified on the negative impacts locally of Mead Corporation of Ohio's takeover of Woodward Corporation, a local steel company. Mr. Baker testified that since the takeover Woodward's employment had declined sharply.

Mr. Richard Schoon, executive vice president (Rhode Island Chamber of Commerce), Providence, R.I., December 1, 1978.—Mr. Schoon submitted testimony noting that after the acquisition of the Nicholson File Company by Cooper Industries, Nicholson's headquarters was shut down and its one hundred employees let go—the headquarters functions were absorbed by Cooper's North Carolina—located headquarters.

Private nonprofit sector spokesman

Mr. Martin Yenawine, chief executive officer, Eastern Ambulance Service, November 2, 1978.—Mr. Yenawine testified that while Carrier's charitable giving averaged $15.00 apiece for each of its employees, UTC's charitable giving averaged only $3.00 per employee. Mr. Yenawine noted that Carrier's charitable giving actually extended far beyond the cited annual per capital expenditure, and included many cultural buildings and cultural grants and loans.

Academic spokesmen

Prof. Allen Young, Syracuse University, School of Management, Syracuse, N.Y., November 2, 1978.—Professor Young testified that his judgment that Carrier is generally assumed to be a reasonably efficient producer was confirmed by his conversation with Wall Street analysts, and that Carrier's status as a reasonably efficient producer makes the case for its acquisition dubious from a public policy perspective.

Mr. Patrick Cihon, assistant professor, Law and Public Policy, Syracuse University, School of Management, Syracuse, N.Y., November 2, 1978.—Mr. Cihon testified that the proposed merger would be violative of existing anti-trust laws in both the "vertical acquisition" area and the "reciprocal buying" area, and then presented specific, substantial documentation of his assertions.

Prof. Richard Oliker, dean, School of Management, Syracuse University, Syracuse, N.Y., December 1, 1978.—Dean Oliker testified in great detail how the powerful position of the rich parent corporation and its ability to put its giant resources into markets which have been considered up to now to be small business markets, may give it an opportunity to sell at prices which approximate cost or below and, by doing so, undercut its less affluent small business competition.

Prof. Malcom Schlussberg, School of Management, Public Policy Department, Syracuse University, Syracuse, N.Y., December 1, 1978.—Professor Schlussberg testified that if part of the values of our pluralistic society is the relative dispersal of power, then each new giant concentration is a body blow at the ideals of a liberal democracy. Professor Schlussberg also noted that the funds required by large firms to acquire other large firms draws investment monies away from new capital projects which could raise productivity and increase employment opportunities and stated that given the current economic environment, with all its weaknesses and problems, the above-noted factor alone mandates a new national policy against conglomerate mergers.

Public officials

Congressman James Hanley, Syracuse, N.Y., Novemer 2, 1978.—Congressman Hanley testified that on a larger scale the subject at hand involves the concentration of economic power in the hands of fewer and fewer corporate entities, which are gaining a broader and broader influence over our daily lives; that it is the gradual increase in dominance by powerful conglomerates which strikes fear in every successful entrepreneur . . . every man and woman who has seen a business grow from infancy to independent pre-eminence in its field.

Congressman William Walsh, Syracuse, N.Y., November 2, 1978.—Congressman Walsh testified that he had read with interest the promises made by UTC with respect to the situation of Syracuse management, the maintenance of improvement of Syracuse employment levels, and perpetuation of local business and philanthropic relationships, and how he remembered that Rockwell International made similar statements when they acquired control of the Poster Cable Power Tool Manufacturing Company of Syracuse, and how those statements have a hollow ring today because Rockwell has since left Syracuse, lock, stock and barrel.

State Senator Marin Auer, Syracuse, N.Y., November 2, 1978.—Senator Auer testified that he intends to propose measures which will require far greater disclosure (than is required) by an acquiring corporation, specifically with regard to the effects of the take-over on small business, the effects of the take-over on minority contractors, and the effect of the take-over on any community where there is substantial employment—such changes to have the effect of requiring a company trying to take over another company to demonstrate that the acquisition is in the public interest as well as the interest of the acquiring company's shareholders.

Mr. Bedell. Thank you, Mr. Stewart.

It breaks your heart that the message you bring to us today, which needs to be told to the whole country, is being told to 20 or 30 people in this room, many of whom would agree with you.

Mr. Stewart. Mr. Chairman, I am going to make every effort to say what I have just said not only to small businesspeople, but I will make every effort to say it to big businesspeople, who have been saying it for 30 years of my life and who are tinkering with the economy; and if they do not face up to the issue, they will be responsible for the failure of the free enterprise system. The American people will not put up with intolerable, uncontrolled action.

Mr. Bedell. We know so well how you have worked toward this, and I am most grateful for the work you are doing. I feel most times you are preaching to an empty church.

Mr. Stewart. I will find the rest of those sinners, Mr. Chairman.

Mr. Bedell. You mentioned legislation. As I understand this legislation proposed by the FTC has not been introduced. Senator Kennedy has similar legislation which has been introduced in the Senate.

Mr. Stewart. Yes, sir.

Mr. Bedell. When we had the FTC and Justice Department before us yesterday, they concurred that this legislation would be helpful. I think it was agreed that although it would be helpful, it would not solve the total problem. Until we make changes in our tax laws, we make it legally possible and acceptable for those 500 or so corporations to continue to take over a larger share of our total economic activity, the problem will exist. Part of the problem is that so frequently our small business community will support legislation which is of little help to the small business community and of tremendous help to those larger corporations who not only become a greater influence in our economic activity, but also exert greater influence in our political and governmental activity.

It is very frustrating to this subcommittee which is dedicated to doing what we can to help our society. We are not intent on going after big business unfairly. We need big business. In fact one of our disappointments has been our steel industry which needs to compete in world markets, but seems to reinvest in areas other than steel. For someone to say that the health of our society concerns them does not make them an opponent of big business.

I do not know if big business looks at us as their enemy because we are asking questions, but it has been disappointing not to have them come before this subcommittee and give examples of successful mergers. They told us there would be an economist here who would indicate their feelings on mergers. But until big business decides they want to cooperate and work to try to solve our problems, I believe our problems are going to become greater and greater. I do not believe the American people will sit by and say it is just fine for big business to say we are not going to cooperate in trying to build a better society, that all we care about are our own individual interests and we are not going to participate in that effort. As chairman of this subcommittee I have been very disappointed in their efforts in that regard. The subcommittee is certainly not here to tear down business. I think your office is performing a great service.

I did not mean to preach to your congregation.

Mr. STEWART. It is your congregation, too.

Mr. BEDELL. We can pass laws and tell people they cannot do things, but if we do not change the structure so it brings about the kind of society most people would like to have, we continue not to address the major problem. You do not solve the problem by trying to force people to react differently. You solve it by establishing a society where there are incentives for people to act in the best national interest.

Mr. STEWART. Our colleagues in the small business community did a magnificent job in setting out a set of recommendations which would be of help; they called for further graduation of the tax, greater simplification of the rollover tax treatment for easing some of the family tax burden so you could leave a business more easily from one generation to another. They called for a new kind of security debenture and a variety of other recommendations, 60 of them.

It just occurred to me, Mr. Chairman, in answer to what you have just said, I am not sure that this committee and the Small Business Administration should, in the face of these recommendations, continue to be the lonely voices we have been. I am not sure what the leadership of Congress should do in the implementation of these recommendations; perhaps it should set up a special task force as the Speaker did for a subject like energy. Maybe it is time we had an intercommittee mechanism to look at all these things together. There is a great risk in these recommendations, too, Mr. Chairman. For 18 months we battled the disaffection of small businesspeople with their Government, their feeling they cannot get anything done by coming to the White House Conference. We overcame it, I think. The President on down, the Members of Congress, all of whom named delegates, helped to persuade the businesspeople in the country that the Government cared to hear from them. If we do not respond with dispatch and sympathy we will add to cynicism and disaffection in a very serious way. That is why I have to agree with you that this committee needs great support among other committees in the Congress which deal with capital and credit and other things like that. I am not sure each member of this committee should not consider himself to be an emissary to other committees so we get the broad-base approach you are talking about.

Mr. BEDELL. If our laws have allowed 500 corporations to acquire 80 percent of our manufacturing assets, if and under those laws the percentage is allowed to grow to 95 or 98 percent then I assume most of the recommendations they offer will be meaningless. Except for the progressive corporate income tax, which I endorse, most of those recommendations would have a limited effect on stopping that movement from 80 percent to complete control. Am I correct in that assumption?

Mr. **Stewart**. Yes, sir. The only specific recommendation has to do with what I read. All the others are supportive in the effort to expand the small business sector, reduce the size of the Government. The restraint on the government-size business structure is the recommendation I read.

Mr. **Bedell**. I would assume a really progressive income tax would help to slow things down.

Mr. **Stewart**. That specific recommendation was overwhelmingly the one that received the most support. Up to $500,000—lifting from $100,000, the point at which you get to 46 percent in the tax rate.

Mr. **Bedell**. That breaks my heart. That is going to help them, but it is not going to do a darn thing about stopping the problem that you are talking about. That will not keep those 500 corporations from building more capital until they own more of our capital assets. The small business community must recognize that they are only going to represent 2 percent of our economy. They will be dead. That thought is a heartbreaker, Mr. Stewart.

Mr. **Stewart**. It is fair to say there has been within the established leadership of the small business community with the exception of John Lewis, who I mentioned, and others, there has been a concern with Government as a menace and not enough attention to government-sized business. Government is omnipresent with respect to small business. It is understandable but it is regrettable. Whatever we do to limit the size of Government will not mean very much to small business if we do not at the same time limit the size of government-sized business and its impact.

Mr. **Bedell**. Does the staff have any questions?

Mr. **Rosenberg**. Mr. Stewart, would you talk briefly about SBA programs to assist where there is a conglomerate acquisition or divestiture, and can you say whether SBA has any programs designed specifically to go and assist small businesses that are trying to remain independent? Also the subcommittee has heard testimony in cases of divestitures where we have an indication that a subsidiary company wants to spinoff and there are difficulties in getting capital to keep that company going during the transition period. Would you comment please?

Mr. **Stewart**. On occasion a 7(a) program may be used or usable, especially where there is an adverse impact, the agency may use its assets to help a spinoff.

You have touched on a void, a place where we need something we do not have. One thing that has occurred to me, for example, is the possibility that the agency might waive size standards in the SBIC program where you are using private capital where a court or FTC orders a divestiture, to finance and assure that the emerging company will be an independent one. Too often now, the pattern is major conglomerate A is ordered to divest of something by a court or FTC, it is taken over by B. It does not add to overall diversity.

I think we need a very affirmative Government program to help to make such legal orders whereby FTC or the court, to have those new companies really be independent, and one problem as you suggest is getting capital to independent managements.

Mr. ROSENBERG. There was some discussion by witnesses in previous days of testimony about the impact, particularly in fairly small communities, when a major employer is acquired by an out-of-town conglomerate and small businesses in that community, smaller than the one acquired, feel the effect of that acquisition. Can you talk about that a little bit?

Mr. STEWART. I have appended to my formal statement a summary of testimony from a hearing we ran in Syracuse which I think is well worth reviewing from the standpoint of the small businesspeople when a business in town is purchased by an out-of-town conglomerate. They did not have anything particularly against one particular conglomerate, but they felt the community impact would be devastating. The acquisition went through anyway, there were some commitments obtained from the acquiring company, and I will say our SBA district office, the SBA in general, did what they could to reassure the small businesspeople in the community that whatever services SBA could extend would be there. But I think you have to step back and acknowledge or take a hard look at the fact that in situations like that, the SBA programs are not well designed to meet the need. They sometimes can help a little, but they are mostly Band-Aids.

Mr. BEDELL. Ms. Hoppe, any questions?

Ms. HOPPE. No, sir.

Mr. BEDELL. We appreciate your being here, Mr. Stewart, and thank you for your testimony.

Mr. STEWART. Thank you, Mr. Chairman.

Mr. BEDELL. Our next witness is Robert Duckworth, Executive Assistant to the Deputy Assistant Secretary for Urban Policy, Department of Housing and Urban Development.

Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. DUCKWORTH. I do.

Mr. BEDELL. You may either read your testimony or summarize it. In any event, it will be entered in the record.

TESTIMONY OF ROBERT P. DUCKWORTH, EXECUTIVE ASSISTANT TO THE DEPUTY ASSISTANT SECRETARY FOR URBAN POLICY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. DUCKWORTH. Thank you, Mr. Chairman, I will attempt to summarize my testimony and leave you the time and opportunity to ask me questions that might relate to our programs as they affect economic development in communities.

My statement briefly touches three themes. The first of these is the President's urban policy announced in March 1978, and the second theme is what localities must do to understand their economic situations, so they can perhaps, where possible, prevent plant closings. The third point focuses on the programs my department offers communities that they can take advantage of in terms of their economic development.

The reason I point to the President's national urban policy as the starting point of my testimony is that the urban policy emphasizes the importance of economic development. A cornerstone theme of that policy is the economic health of our communities means a healthy policy for this country. It attempts to strengthen and maintain economic viability in those communities that are about to face economic traumas such as plant closings.

The urban policy also recognizes that promoting economic development is not just a public sector job; it is not just a private sector responsibility. It is the responsibility of both coming together to assure sound urban economies.

Since the announcement of the urban policy, we have attempted to bring together the public and private sector in some of our programs. One of those programs is the Urban Development Action Grant program which best illustrates that theme.

When we talk about urban economic development, it is really the framework within which Federal and community economic development assistance programs ought to be linked.

At the local level, in my prepared statement I present some thoughts on what a community should do in understanding its economic situation. I think Ms. Cutler this morning, when she described the process at Waterloo, described what I was attempting to get at in the second part of my written testimony. That is, a locality—when it sees problems and when it looks to the future to understand what it can do economically—needs to get together at the local level, the public officials, the business community, labor and the citizens to see what the community can and cannot do, especially where there is the potential of plant closings. They need to look at what the public sector can do in the way of public improvements and in the way it can respond to industrial possibilities that might come into a community. They need to know what the capacity of their community is to diversify its economy. They certainly need to look at their housing supply and their community development. Essentially, they need to look at those things that make a community productive and a healthy place to live and work. We call that an economic strategy. We would hope at the local level that before any thought is given to addressing economic problems that the entire economic picture for a community is taken into account.

There are programs the Federal Government has to offer that help a community go through this kind of thinking-out process, a process where they should identify their economic development strategies and the ways to carry out those programs; EDA has programs to do that as well as our department.

What is it that we can offer? What is it that my department can offer to communities that are going through economic disturbances because of plant closings?

There are several programs which reflect the economic theme of the urban policy. There are two programs within HUD in particular that we might want to consider here. The first of these is the Community Development Block Grant program. While that program has several objectives in it, in 1977 it singled out urban economic development as a very important objective that we wanted to put our investment behind. While it is a bit early to see what progress has been made in terms of economic development in that program, there are some signs.

Much of the housing and community development, CDBG, program goes to economic development at the neighborhood level. When we are talking about small businesses, one can look at this program as an opportunity to enhance small businesses in urban communities, especially those communities in distress, also those small businesses that might be minority and might serve the needs of low- and moderate-income people.

Perhaps the most important program that HUD has to offer in the way of urban economic development is its UDAG program which provides grant funds to distressed communities across the country for public improvements, site improvements, revitalization of economic activity, to provide loans to industries to improve their operations and to invest in their capital plant.

That program was illustrated previously this morning with Waterloo. In my testimony, there are a number of examples that I give, certainly not all the cases that we have, which show what that program is doing.

When we think about the Action Grant program and what it can do in terms of localities facing plant closings, we can look at it in two ways: First as a preventive program, that is where a community, once it gets its economic strategy together and knows where it wants to go can look at the opportunities in that community and begin to tap Federal resources to help out.

For example, where there is a threatened plant closing because there is not enough public infrastructure, as to improvements, there is assistance available. So in a preventive sense the program can and has helped some communities deal with the shutdown of economic development in their communities by helping some of the industries in those communities.

For example, if we look at Shelbyville, Ind., Action Grant funds were used both to improve the streets and the site upon which a fiberglass company could remain and expand its operations. Because we did that we were not only able to keep the fiberglass company in Shelbyville but we were able to expand its operation and job base.

The Action Grant program as I said can also be looked at as a remedial program. There are examples in my testimony where that has occurred. For example, in Akron, Ohio, Action Grant funds were used in conjunction with other State and local funds to improve the public infrastructure, improve the sites, and help the Goodyear Rubber Co. to transform a facility for its research and development activities.

My department has programs which can step in and help communities with its economic development, but there are some limitations we need to be aware of which these programs have.

I might just go through some of those within the Action Grant program.

That particular program does not apply to all communities. It only applies to those communities suffering economic and physical distress. We have six criteria which spell out what distress means, and the census puts together the data for those criteria. We have identified about 323 communities now that fit within the distress criteria which are eligible for Urban Development Action Grant funding.

In addition, a locality must show that it is really serious about the housing and job needs of its citizens, especially its low- and moderate-income citizens. So we require there be a demonstrated capacity before getting this funding assistance.

One of the most important elements of this program is that we want to create partnerships with the private sector. We use the funds to leverage financial commitments from the private community. When we evaluate it, we look at it in terms of this commitment and the private sector dollars that are leveraged as a result of the public sector investment.

There are other programs identified in the department, less important and less significant programs, but what I think we need to do is keep our attention on the Urban Development program and the Community Block Grant program as our two main economic tools.

Mr. Chairman, with that, I would like to say our department has traditionally been seen as a department that tends to housing and community development needs of the country. As a result of the urban policy we have interpreted that to mean economic development, providing jobs. We would like to be perceived also as an agency that helps communities get through their economic troubles and helps communities address their economic needs.

Thank you. I think that concludes my comments, and I am ready for questions.

[Mr. Duckworth's prepared statement follows:]

PREPARED STATEMENT OF ROBERT P. DUCKWORTH, COMMUNITY PLANNING AND DEVELOPMENT, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Good morning, Mr. Chairman and members of this distinguished subcommittee, I am pleased to join you today and testify on behalf of the Department of Housing and Urban Development at these specific proceedings. We do play a role in promoting economic development efforts at the local level, in carrying forth our community development responsibilities. In addressing the concern of this subcommittee hearing—i.e., how the Federal Government through its programs and actions can help local economies affected by plant closings—I would like to:

First, give brief reference to the President's Urban Policy which is relevant to this subject;

Next, stress the need for realistic, locally-initiated—but federally supported—economic development strategies;

And finally, highlight the Department's economic development program tools—especially the Community Development Block Grant and the Urban Development Action Grant programs—and their efforts in helping communities with their economic development pursuits.

I. THE PRESIDENT'S URBAN POLICY

As many of you know, in March 1978 the Carter Administration launched a national Urban Policy, committing the Federal government to support states and localities in addressing the complex urban problems plaguing this nation—problems of loss of industry, declining tax base, strained municipal budgets, decaying buildings, unemployment, poverty, crime, vandalism, drugs and illiteracy to name a few. While Mark Twain might have said—if he were alive today—that "everyone talks about the urban problems, but no one does anything about it", through the Administration's Urban Policy, the Federal government is helping to tackle our urban problems.

The Urban Policy declared a national commitment to the economic health of our cities and communities and their citizens. It encouraged Federal actions to strengthen local urban economies and help those urban places encountering economic difficulties to cope smoothly with, if not recover from, those problems. It was and remains the assumption of the Urban Policy that the overall well-being of our nation's communities is critically connected to the economic health of our nation. Healthy and productive communities mean job opportunities, provision of goods and services and are vital in terms of tax revenues which make a community an attractive and competitive place to live and work.

The Urban Policy recognizes that jobs—the earning power of the people—are the lifeblood of our economy, our cities and communities. It recognizes that the retention and creation of jobs is a joint public/private responsibility and is integral to sound urban economies. On the one hand, private enterprise must shoulder the burden of investment in market opportunities, develop sources of capital, take the risks and complete successfully—and in the process create jobs. On the other hand, public sector decision making and actions must be linked to private sector needs—to assure that cities or communities are healthy, competitive and productive places to work and live for all urban residents, especially those urban poor and disadvantaged who have been left behind or left out.

It is the Urban Policy through which all current Federal assistance efforts are rooted in assisting communities to rebound from economic hardships such as plant closings. And HUD is playing a major role in this Policy.

II. Local Economic Development Strategies

This brings us to the problems of localities experiencing actual or potential plant closings. What can be done at the local level? At the outset such communities need to reassess candidly each of their situations. They need to understand the economic transition through which their communities are going and identify what can be realistically expected. These localities need to know what their communities can offer in holding or attracting industry and what opportunities are available for plant expansions and modernization. They need to know how the limitations on these opportunities—such as inadequate transporation or land access, deteriorated community infrastructure or environmentally inefficient plants—can be addressed through public action.

A key to local economic recovery or adjustment then rest in self-initiated local public sector actions which will encourage private sector investment decisions and make the community a place where the cost of doing business is competitive. In taking stock of the local economic situation, local policies must be framed within an economic development strategy aimed at holding capital investment, if not increasing it. The local business community—that is, representatives of labor and business—must be involved actively in this strategy at every phase of its process, examining various areas of local public decision-making that might affect the decision of a business to remain or expand or cause it to leave. All the "economic drawing cards" for sound private investment must be coherently tied together, such as:

The adequacy of public infrastructure facilities, are the essential infrastructure elements—the roads, waste treatment facilities or energy infrastructure—in place and if not how can they be?

A locality's ability in outreaching for industrial activity. Can it respond rapidly to zoning problems, finance problems or labor problems affecting the locational decision of a plant? Can the community institutionally encourage economic development activity by demonstrating its ability to deliver public services and cut through administrative red tape when an economic opportunity arises?

The capacity of the locality to diversify its economic mix, while still seeking to strengthen or maintain the existing industrial component of its area. Not every type of business activity fits a community and therefore what constitutes a locality's market and product must be delineated.

The availability of the local skilled labor. Does a locality's available job skills match the current or potential business need? If not, how can the locality invest in bridging the gap between the manpower situation and job skill requirements?

The provision of improved housing. Although expanding housing opportunities does not in itself bring industry back to the community or attract economic activity, such opportunities do reinforce the other "economic drawing" cards.

The possibilities of a community to make available necessary land parcels which are prohibitively costly. Can the locality initiate various arrangements such as land assembly or leasing techniques to entice industrial and commercial developers, avoiding large equity payments for expensive urban land? Or what are the possibilities for recycling old vacant plants?

Once this kind of self-initiated local strategy is in place, the next step is to identify which state or Federal policies and programs can be tapped in implementing the economic development strategy. In the short haul this means seeking economic development opportunities and mobilizing the appropriate resources for tapping these opportunities. HUD's community development programs can be an important tool in this effort.

III. HUD'S COMMUNITY DEVELOPMENT ASSISTANCE

There are two major programs which should interest localities confronted with plant closings and who have launched economic development strategies to address this situation—the Community Development Block Grant Program and the Urban Development Action Grant Program. In addition, there are other minor programs worthy of attention—the economic development loan guarantee program, linked with CDBG, and the low-interest rehabilitation loan program, known as Section 312.

The Community Development Block Grant (CDBG) Program.—This program, signed into law in 1974, consolidated seven previously separate, categorical programs—urban renewal, model cities, open space, water and sewer facilities, neighborhood facilities, rehabilitation loans and public facility loans. The CDBG program radically departed from earlier Federal community development programs. It offered the nation's cities an opportunity to formulate their own strategies to assist low- and moderate-income people, eliminate slums and blight, and meet other urgent community needs. For the first time, all HUD community development funds went directly through city hall with local officials and their citizens determining how these funds should be expended, thereby allowing local versatility in meeting community objectives.

Since its inception almost $15.5 billion has been committed to some 12,400 communities, both large and small, and another $3.8 billion is to be provided in 1980. With this major funding amount the CDBG program has become one of the most important Federal programs for carrying out the President's Urban Policy—and for assisting the communities of this nation in responding to their increasing community and economic development needs. The large cities (those over 50,000 in population or central cities in standard metropolitan statistical areas), called "entitlement" cities, have received the major share of CDBG funds through a guaranteed amount of funding (based on one of two formulas measuring levels of community need). The small cities (those under 50,000 in population) must compete with other small cities for a limited amount of CDBG funds, made available on a statewide basis.

In 1977, the Housing and Community Development legislation singled out economic development as a specific statutory objective of the CDBG program, although it was contained in the primary objective of the original legislation in 1974. As a singled-out CDBG strategy, economic development became aimed at helping a locality develop its economic base, provide retail services in low and moderate income neighborhoods and create or retain jobs, particularly for low- and moderate-income residents. These legislative changes were followed by regulatory changes which restated the eligibility of many activities which were and continue to be valid for general economic development purposes and added certain other activities that were previously ineligible. The major regulatory changes include:

Allowing improvements of public facilities not otherwise eligible for CDBG assistance to become eligible under economic development.

Strengthening the loan guarantee provisions for economic development under the program.

Clarifying as a valid activity the eligibility of land acquisition of real property for economic purposes.

Permitting the use of CDBG funds for the construction of commercial and industrial facilities.

Expanding the use of the CDBG program fund to include local development corporations, neighborhood based non-profit organizations and small business investment corporation organized for minority enterprises—where these entities are engaged in economic development activities.

While it may be a bit early to access fully the impact of these legislative and regulatory CDBG changes, there are some illustrations of their consequences. For example, Minneapolis, Minnesota has directed its community development funds to support increased economic development activities by acquiring a major downtown site for a minority owned firm to build an electronic plant adding jobs and tax base to the city. In the same spirit, Detroit, Michigan—using CDBG funds to back economic development loan guarantees and to convert a major site formerly planned for an interstate highway for industrial development—is attracting new industry to its city. Utica, New York has developed a successful economic development reinvestment program by leveraging private commercial and industrial investment with CDBG funds. And, Tacoma, Washington has organized a city waterway redevelopment program including conversion of an old warehouse into shops, restaurants and office space.

Thus, the CDBG program is enabling many cities to achieve economic revitalization as a part of the local community development process. Still, as CDBG applies to communities facing the economic crisis of plant closings, there are limitations in using this program.

First, the entitlement nature of the program—with applications submitted once a year—does not make it conducive to respond to immediate, emergency plant closing crisis. Notwithstanding this, the program can however serve a major contribution in assisting a locality in its economic development strategies over the long haul.

Second, the program as a whole is tilted toward benefitting lower as well as moderate income local residents. Thus, any local response to preventing or adjusting to plant closings which involves CDBG funds must take into account the low- and moderate-income needs of its residents.

And, third the CDBG program has seven other specific objectives—from the elimination of slums, blight and detrimental conditions to conserving and expanding housing stock to reducing the isolation of income groups and promoting neighborhood diversity and vitality. As such, funding at the local level must compete with these other community development needs, while addressing low- and moderate-income needs, and reducing blight. However, the other community development needs, as noted above, are the "economic drawing cards" for economic development and could be mutually supportive, if properly conceived.

The Urban Development Action Grant Program.—The Action Grant program is one of the newest economic development programs the Federal government has to offer localities and perhaps the most innovative. It is seen by many as the flagship among all economic development programs. Its funding began in 1978 and this year it provides $675 million to stimulate local economic development in distress cities and neighborhoods, through private/public sector partnerships. As of January 1980 some $1.1 billion has already been provided to 357 communities, both large and small, throughout the nation and it has leveraged over $6.3 billion in private sector funding commitments. The average UDAG funding amount for large cities is about $3.0 million and $850,000 for small cities.

The program allows a wide range of eligible economic activities to support a local private/public economic development effort including land clearance, site improvements, infrastructure needs; and, rehabilitation and construction of public, commercial industrial and residential structures. In addressing the local economic development needs through these activities, the Action Grant program has earned a reputation for its rapid response as applications are submitted quarterly and reviewed within sixty days by HUD. In this respect the Action Grant program can be a far more effective program than the CDBG program in meeting local emergency economic crises such as plant closings.

The Action Grant program can be creatively applied to local situations threatened with plant closings. In fact the program can aid localities in preventing potential plant closing situations where expansion or modernization improvements are difficult to accomplish without public support. There are many rich examples which illustrate the versatility of the Action Grant program in preventing the closing of industrial plants or commercial facilities and in retaining and expanding a locality's job base. Among these are:

Shelbyville, Indiana is using Action Grant funds to undertake street and site improvements, improve sewer and street lighting facilities and developing a pedestrian mall—all of which has encouraged Knauf Fiberglass to remain, and expand its present facilities. This effort has not only retained existing jobs, but has lead to the creation of 150 new permanent employees.

In Buffalo, New York tenants have formed a corporation to purchase and renovate an eight story warehouse/industrial building—thereby allowing this building to remain in use and retaining its current employees.

And, Action Grant funds are assisting Rochester, New York by providing a $5.15 million loan which—along with $25.5 million in private capital—will help an existing manufacturing firm remain and expand its operations, and add almost 600 new jobs by 1985.

There are also many Action Grant program examples whereby localities have been able to recover from lost economic development activity. Among these include:

Akron, Ohio has received Action Grant assistance along with other Federal and state funds for public infrastructure improvements making possible the expansion of the Goodyear Tire and Rubber Company. Goodyear with these public improvements is able to rehabilitate a vacant factory, transforming it into a campus-like facility for its research and development center. It is also able to expand this part of its operation to include over 500 new permanent employees.

Because of the Action Grant program Irvington, New Jersey has been able to attract a major wine distributor to the city. In this case the locality was able to use these funds to provide a second mortgage loan to the wine distributor, encouraging not only a relocation of the company to Irvington, but an expanded operation.

And, Hornell, New York has been able to acquire and renovate a vacant manufacturing facility, which the city's industrial development agency will lease to a private manufacturing firm. This project is significant not only because of the city's efforts to recycle a vacant building, but also because CETA funds are being used to train employees for the firm.

Although the Action Grant program can provide rapid response, there are some program features localities facing plant closings must take into account in using the program.

First, not all communities are eligible for Action Grant assistance. Determination of eligibility is based on six economic and physical distress criteria (such as growth in per capita income from 1969 to 1974, employment growth from 1967 to 1974, employment growth from 1967 to 1972, the local unemployment rate, the percentage of housing stock constructed before 1940, the locality's poverty level and its population growth from 1960 to 1975). Only 323 large cities (having populations of 50,000 or more) and 10,000 small cities (housing populations under 50,000) are eligible. Recently, the program has been revised to also accommodate non-distressed localities having pockets of poverty conditions and whose eligibility is based on similar distress criteria for the particular distressed neighborhood (or poverty pocket).

Second, localities receiving Action Grant assistance must demonstrate results beforehand in offering housing opportunities for low and moderate income persons—and they must demonstrate an active affirmative housing and job program. Not all communities have been completely successful with this program feature.

Third, local eligibility for Action Grant funding is also based on the private sector being actively involved in the Action Grant assisted project. This specifically means the locality must prove evidence through letters of intent or legally binding commitments indicating that the private sector will participate financially in the project.

Fourth, after HUD determines eligibility, a locality's application is accepted for review. In this review there are established criteria for funding approval, including the impact of the project on low and moderate income individuals and minorities; the nature and extent of private-sector participation (as noted below); the nature and extent of other Federal funding; the extent to which the project creates permanent new jobs or retains current permanent jobs; demonstrated performance in carrying out housing and community development programs; and, UDAG dollars required to create one dollar in new local taxes.

And fifth, the locality must maximize the leveraging of private sector dollars with the Action Grant fund. While no specific ratio is required, applications having less than 2.5-to-1 ratios will not be favored. In determining these ratios, HUD considers only private sector financing—revenue bonds, equity funding and donations from private institutions.

Other HUD programs.—There are other HUD programs which can be identified here, but which are not as significant as the CDBG and UDAG programs. An example is the Section 108 loan guarantee provisions, until recently an infrequently used economic development tool. Under this CDBG tool HUD can guarantee notes or other obligations of local governments—which are CDBG entitlement recipients—to help finance a community's economic development activities. In receiving such loan guarantees a locality must pledge its current and future receipts of CDBG funds as security for the loan. This program has the potential for rapid delivery to CDBG localities wishing to take preventive or remedial plant closing actions.

In addition, HUD through its low interest section 312 rehabilitation loan program can provide assistance to localities for major and minor rehabilitation of business, as well as residential, properties located in locally designated community development areas. This program has only recently been used significantly for non-residential rehabilitation purposes because of limited funds. With additional funding recently provided the Section 312 program has potential for rapid response in certain economic development situations. For example the Section 312 program has been able to assist localities such as Mobile, Alabama provide rehabilitation loans to help owners modernize their commercial office building, rather than relocating to new facilities.

IV. CONCLUSION

While the Department of Housing and Urban Development, created in 1965, is the principal Federal agency responsible for programs concerned with housing needs and developing the nation's communities, it can and is doing much more to help our nation's cities and communities. Today as noted in this testimony, we are interested in carrying forth the President's Urban Policy. This entails, besides our traditional role, being perceived as one of several agencies which are to promote economic development at the local level—and by involving the business community in this process. Only in this way can the needs of all urban residents, especially the poor and disadvantaged, as well as the demands of local economies affected by plant closings be met.

Thank you, Mr. Chairman.

Mr. BEDELL. Thank you, Mr. Duckworth.

We have heard testimony indicating that once a plant closing is announced, the time required to get Government assistance precluded a timely reopening of the facility. Is there a time problem if a community finds a plant is going to close in 4 months?

Mr. DUCKWORTH. There might be a problem, depending on the programs we are looking at. This program is a program which allows applications to come into HUD once a quarter, four times a year. The other program, the Community Development Block Grant program, is a program which receives applications once a year. So obviously if there is an emergency there might be some difficulty with the timing of these two programs. Although I might say the action grant program has been able to, in some illustrations which I have identified, has been able to address emergency situations and before they occur, prevent them.

Because we have through a decentralized field structure, because of that, we are pretty much aware of a lot of communities, and we know from the moneys they get what their situations are, generally speaking. We have been able because of our Community Development Block Grant program, to get a picture of the situation that might be a troublesome situation economically, and we were able to move in and provide advice and technical assistance and help that community with Action Grant moneys.

So, even though there is the problem of timing and getting applications in, we are pretty much aware of the communities we are working with and their difficulties, and we try to help them in getting applications in before the time period.

Mr. BEDELL. Do you think your department has a problem meeting the needs of communities faced with plant closings in a timely fashion?

Mr. DUCKWORTH. I feel we have not run into—to my knowledge—into situations where we have not been able to capture opportunities, to my knowledge, with our Action Grant program. We have been relatively speaking—able to get on top of situations and help out.

Mr. BEDELL. In the Goodyear situation you mentioned, how did that work? Did you give a grant to the corporation similar to the one EDA administered in Waterloo?

Mr. DUCKWORTH. In the Goodyear situation it was a bit different. Again, the employees for example were not seeking stock ownership. The objective of the Goodyear project was to improve the surrounding community of a site which required public improvements, streets, et cetera. It also required us to help the locality improve the site itself and help the locality provide Goodyear assistance so that they could expand their facilities. Now Goodyear, and I am not sure what the amount of private sector funds they put into the project was, but they sat down with the locality and said if you could provide these public improvements and help us in terms of the site and in terms of helping us to get the financing we need to rehabilitate a vacant factory, we will recycle it, and not only that but we will put a major amount of our capital into that improvement.

Mr. **Bedell.** Was this a vacant factory?

Mr. **Duckworth.** Yes.

Mr. **Bedell.** Would it provide new jobs for the community?

Mr. **Duckworth.** As a result of that project we expect 500 new employees in that situation.

Mr. **Bedell.** Was tne other help given to Goodyear similar to the situation at Rath where a grant was given to the community?

Mr. **Duckworth.** That is correct. The money in this case was used directly by the city for public improvements and also to help Goodyear in obtaining its improvements.

Mr. **Bedell.** I understand the site improvements. Do you know how they gave financial help to Goodyear? Was that a loan to help rehabilitate the building?

Mr. **Duckworth.** I am not sure whether it was a loan or a grant, but there was financial assistance given to Goodyear. I am not sure what the instrument was. I suspect it was a loan that came from the Action Grant money that went to Akron. If you want me to, I will take that question back and provide the information for the record.

Mr. **Bedell.** I assume Goodyear is not in financial difficulty. Is it really the purpose of the Federal Government to take taxpayers' dollars—and loan or give this money—to a community who loans the funds to a corporation like Goodyear so they can establish a plant in that community? I am well aware of the community benefits that may accrue. On the other hand I would assume if a plant is activated and hires 500 people, there would be some dislocations in other communities as a result of that activity. Is this something most taxpayers in the country would believe to be a good expenditure of taxpayers' money? I get a little disturbed if we are saying that big corporations can come in and induce or threaten a community, and get Federal tax money to be spent to aid Goodyear Tire & Rubber Co.

Do you understand my concern?

Mr. **Duckworth.** I understand your concern, and it is indeed well taken.

The objective of what we are trying to do at HUD—those objectives have to be seen in the light of how can a community strengthen its economic base, how can we strengthen the possibility for jobs, and I must say some of the jobs as a result of this improvement will include low- and moderate-income people who did not have jobs before this improvement. Goodyear already has a facility in the community. The question was how can a locality keep the facility in its locale without it moving someplace else and how can a community take advantage of an in-place plant and expand it.

So when we are talking about the taxpayers' dollars, we are talking about how can we keep a community viable economically, no matter what the operation, whether it is Goodyear or some other operation, if that operation is going to move. The purpose here was to keep it, expand it, and in the process help the community both in terms of jobs and its community development.

While that may not be satisfactory in answering your question, I think there are other aspects that have to be looked at as well.

Mr. **Bedell.** We have a number of different agencies that are giving this type help. I have problems with Waterloo. I question whether that money should have been grants or loans if it is to be used to keep a corporation in business.

Mr. **Duckworth**. With the Action Grant program, one of the weighing factors in approving an application is not only how well will the project involve the private sector, but what other public funds can be tailored to the project. So we work with EDA, CETA, in a number of these projects. One of the questions in Action Grant funding is, are there other State or local or Federal funds in the project? So we are attempting to coordinate the limited resources we have among agencies at the local level. Here in Washington, we also try to coordinate these projects. You are right, they have different requirements for getting funding, but as to the urban policy framework, one of the things we wanted to do was to bring agencies together around common programs.

Bob Embry and Bob Hall and people from SBA and other places meet on a regular basis to discuss generally how to coordinate these programs. In addition, where there are projects allowing a bringing together of funding arrangements, they meet on that. I am not saying we have gone as far as we could or should, but there is an effort to bring these different programs together in a joined way to address the needs of local communities.

Mr. **Bedell**. Do I understand that the Goodyear situation involved an empty building——

Mr. **Duckworth**. A vacant factory.

Mr. **Bedell** [continuing]. That had not been operated for some time?

Mr. **Duckworth**. That is right.

Mr. **Bedell**. And this was a grant to a city which could either give or loan money to Goodyear to help them open a plant and offer jobs?

Mr. **Duckworth**. To stay in that community.

Mr. **Bedell**. It was an empty building, was it not?

Mr. **Duckworth**. Part of the Goodyear operation was there.

Mr. **Bedell**. Was there a threat they would pull out?

Mr. **Duckworth**. I do not know, but part of the program is to help where we can expand the economic base. In this case I think that is what we wanted to do. I think there may have been some concern that Goodyear's research and development operations would go somewhere else and there was this vacant factory which could be improved and taken advantage of. The community wanted to capture that opportunity.

Mr. **Bedell**. Was any check made to see if it would result in significant job losses in other communities?

Mr. **Duckworth**. That I do not know. I will look into that.

Ms. **Meyer**. I am Diana Meyer, from the Office of Legislation at HUD, and I am also from Akron.

The factory involved had been closed by Goodyear 6 months before. It was a sudden action and there was nothing the community could do about it at the time. About 6 months later Goodyear came to the city and said we are planning a research facility, and we can build it in a rural area which was not very populated, or we can use this factory. At the time Goodyear had about $80 million they were willing to put into it. But around the facility, they needed a new access highway, and there was the old Ohio Canal that needed to be improved. So it was a situation where it was Goodyear's plant, but it was outdated, and they were going to turn it into a better use. Leaving it there I think it would have cost a lot more to turn it into a new factory.

Mr. BEDELL. My question goes to beyond the improvements which were needed to the streets. Was there any sizable money given or loaned to Goodyear for the improvement of the building itself?

Ms. MEYER. It is my understanding very little if anything went to Goodyear itself. Most of the money went into improving the surrounding area. If anything went to Goodyear it would have been something like a very small second trust.

Mr. BEDELL. Is that proper policy? I have no argument about improving streets; that is part of the community's job. But I think it is proper to question whether taxpayers' money should go to help Goodyear Tire & Rubber improve a plant, particularly if it ended up as grant money.

Could you check on this for us?

[Information supplied by the Hon. Robert Duckworth in an addendum dated February 12, 1980, follows:]

THE USE OF URBAN DEVELOPMENT ACTION GRANT FUNDS IN AKRON, OHIO

Action Grant funds in this project totalled $11.4 million. The city of Akron used this assistance for public infrastructure improvement (i.e., sewer, streets, sidewalks) and site improvements.

Because of this Action Grant, Goodyear is able to invest $75.0 million of its capital for renovation of a vacant factory on the site being improved by the Action Grant funds. No Action Grant funds were used by the locality to provide a grant or loan assistance to Goodyear for actual renovation of the vacant factory.

Mr. BEDELL. Does staff have any questions?

Mr. ROSENBERG. I have one question which arises out of hearings held last week with the witnesses from Youngstown, Ohio. As I recall the testimony they gave at that time, HUD money was used to finance a feasibility study of reopening of the closed steel mills in Youngstown. The study was then presented to the Economic Development Administration, which summarily rejected the study and said the plan was not workable, and therefore they would not consider loaning funds.

What kind of quality control mechanism is at work here? At HUD, before you sign the check and pay for the feasibility study, that another Government agency then says will not work, when do you come in and determine that the work product is worth paying for?

Mr. DUCKWORTH. We had very close contacts with EDA; in fact we had a working relationship with the EDA officials, and we had a working relationship with other agency officials. When this study was put together and we funded it, we wanted to see what we could do in this emergency. So it was not a question of where we went out on our own and helped the locality with technical assistance moneys; we did it jointly with other Federal agencies involved.

As I understand it, the problem was not that the conclusions of the study were faulty, the problem was the Federal investment to go back into that community to help it recover was prohibitive. I do not know the details, but that is my understanding. It was not a question of the right hand and left hand going in different directions. Very early in the process, we were working together with the

White House Interagency Coordinating Council in trying to deal with that particular problem.

Mr. **Bedell**. It would be helpful to get us that information. The people who came before us from Youngstown indicated the Government had not been as cooperative as it should have been. Mr. Hall is coming before us, and it would be helpful to have that information.

[Information supplied by the Hon. Robert Duckworth in an addendum dated February 12, 1980, follows:]

Federal Coordination in the Youngstown Steel Situation

HUD with its CDBG funds contracted with the National Center for Economic Alternatives (NCEA) to assess the range of possible options for assisting the city of Youngstown in responding to the closing of the Youngstown Sheet and Tube facility. This study was coordinated in every phase among the involved Federal agencies such as Commerce/EDA, Labor, SBA and EPA. These Federal agencies meet in working group sessions under the guidance of the White House Interagency Coordinating Council to address this local economic crisis. This group, known as the Youngstown interagency coordinating committee and chaired by EDA, used the findings of this study as well as other studies in its efforts.

At the local level, the NECA study was also coordinated throughout every phase with the Mahoning Valley Economic Development Committee and the Ecumenical Coalition of the Mahoning Valley, Inc.

Mr. **Rosenberg**. You referred to the Interagency Coordinating Council, and earlier you talked about meetings between EDA, HUD, and other agencies. I would be interested in getting a more precise description of how that coordination occurs.

Are these toplevel meetings where HUD talks to Commerce, or do you have specific task forces which determine that you look at Youngstown or Black Hawk County——

Mr. **Duckworth**. The Interagency Coordinating Council is a council with Jack Watson's cooperation at the White House. The people who come together at the council table are assistant secretaries of the agencies which have an urban mission—that is, SBA, EDA, HUD, and others. They meet on a regular basis, and they meet also one-on-one. If there is a need to get HUD together with EDA, then we work jointly on specific needs outside that council but within the umbrella.

In terms of specific projects and concerns, it does have task forces that it assembles which look into these concerns. People like myself work with those task forces. I work with people from other agencies. So, there is a variety of ways they attempt to coordinate.

Mr. **Rosenberg**. I am sure Chairman Bedell has far more personal experience in this area, but I do recall when I was working in a Member's office; sometimes, a problem such as the one we have discussed would arise. Frequently the community leaders would come into Washington and sort of go shopping. They would have a list of agencies and they would go around knocking on doors until they found one that might help. It is a haphazard approach, particularly if we are faced with a merger-related plant closing, when a company says, "In 2 months this plant will be closed," and all of a sudden you have officials running off in all directions and you cannot catch them.

Mr. **Duckworth**. Are you asking a question?

Mr. **Rosenberg**. How do all these programs come together in one community, as opposed to the broad discussions that occur in the White House?

Mr. **Duckworth**. They do not come together well enough. They may come together better now as a result of our understanding of the need to bring them together. There is an attempt to bring some of it together, especially where there are specific concerns that need to be looked at. Then the White House Interagency Coordinating Council will be brought into this.

We are making an effort to somehow bring some of that together.

Mr. **Bedell**. Ms. Hoppe.

Ms. **Hoppe**. No questions.

Mr. **Bedell**. We thank you very much.

On our next panel are William Batt, executive secretary, Commerce-Labor Action Committee, Robert Anderson, Administrator, Office of Comprehensive Employment Development, Department of Labor, and Marvin Fooks, Director, Office of Trade Assistance, International Labor Affairs Bureau, Department of Labor.

PANEL CONSISTING OF WITNESSES FROM THE DEPARTMENT OF LABOR: WILLIAM BATT, ROBERT ANDERSON, AND MARVIN FOOKS

Mr. **Bedell**. Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Batt**. I do.

Mr. **Anderson**. I do.

Mr. **Fooks**. I do.

Mr. **Bedell**. It's good to have you here. It has been a pleasure to work with Mr. Fooks on some of the problems I have had in my district. You may proceed in whatever order you wish as to your testimony. You may either read it or summarize it, as you wish.

TESTIMONY OF MARVIN FOOKS, DIRECTOR, OFFICE OF TRADE ASSISTANCE, INTERNATIONAL LABOR AFFAIRS BUREAU, DEPARTMENT OF LABOR

Mr. **Fooks**. I will start off, and Mr. Batt and Mr. Anderson will have remarks later on.

I appreciate this opportunity to appear before you today. I understand that the subcommittee is interested in Federal efforts to assist local economies affected by plant closings. Initially, I should point out that the Department of Labor does not have expertise in conglomerate mergers or their effects on plant closings. We have not yet put any meaningful material together but we will make an effort to supply at a later date this material to the committee. Our program responsibilities are directed principally toward worker assistance. In this regard, the Department administers programs under the Comprehensive Employment and Training Act—CETA—and the trade adjustment assistance program under the Trade Act of 1974. With me today are William Batt, executive secretary of the Commerce/Labor Adjustment Action Committee, and Robert Anderson, Administrator, Office of Comprehensive Employment Development of the Employment and Training Administration. Mr. Batt will answer any questions you may have on joint efforts of the

Departments of Labor and Commerce in assisting the economic recovery of import-impacted communities and to tell you something about an action checklist recently released by the Department of Labor entitled, "A Guide for Communities Facing Major Layoffs or Plant Shutdowns."

Since we are aware of your interest in the case of Rockwell International Corp.'s Draper Division plant in Hopedale, Mass., Mr. Anderson will answer any of your questions with regard to the CETA program which provided assistance to many of those workers. As Administrator, he is responsible for the development and administration of programs aimed at increasing the employability of, and providing jobs for unemployed and underemployed persons.

In early 1979, the Hopedale subgrantee of the Massachusetts balance of State prime sponsor program began its own computer test technician skill training program. The course lasts for 6 months and has had 50 graduates with a 100-percent placement rate. Followup verification has shown all graduates to still be employed in the data processing industry, with some having upgraded themselves with either their original employers or with new employers. There are presently 20 participants due to graduate in March and the subgrantee states that a considerable number of job openings have been received for these individuals. As an aside, we are looking for someone with that expertise in my office. The subgrantee is expecting to move into a new location at the former Draper/Rockwell facility in order to enlarge its program.

My expertise is with the trade adjustment assistance program. Under the trade adjustment assistance program, the key factor in triggering program benefits is increased import competition. On some occasions, of course, corporate mergers or acquisitions are associated with import-related decisions to reduce overall capacity or shift production elsewhere in the United States or even abroad. Two instances where such a situation occurred were the closing of the Youngstown Sheet & Tube's Campbell Works in the fall of 1977 and the earlier closing of Rockwell International Corp.'s Draper Division plant in Hopedale, Mass. In both of these instances, the trade adjustment assistance program was able to maintain an important part of the laid-off workers' income stream with positive effects not only for the workers and their families, but also for retail and other establishments in the affected communities.

Trade adjustment assistance consists of specific benefits, which exceed regular unemployment compensation, to totally or partially laid-off workers where increased competitive imports have been found to be an important contributory factor in their layoffs. Inaugurated under the Trade Expansion Act of 1962, the program was considerably expanded under the Trade Act of 1974.

The application process is a relatively simple one. Three workers, a union official or other duly authorized representative of the workers file a one-page petition form. Upon its receipt, the Office of Trade Adjustment Assistance institutes an investigation. Typically, an investigator visits the plant and collects sales, production, and employment data as well as information identifying customers of the workers' firm. The Department conducts a survey of customers' purchasing patterns to determine whether the customers are switching to or increasing their reliance on other domestic or foreign competitors of the workers' firm, a key element of the investigation.

If the Department finds that the firm—or subdivision of the firm—has experienced a production or sales decline, that a significant number of workers have been wholly or partially separated—or are threatened with such separations—and that increased competitive imports have been an important factor in the layoffs and decline, we issue a certification to the petitioning group, establishing an impact date on or after which the worker layoffs are covered by the certification. Certifications are usually valid for 2 years; they may be terminated earlier.

Once the Department issues a certification, individual workers of the certified worker group must apply for benefits at their local State employment security office. To be eligible for trade readjustment allowances—TRA—and relocation benefits—a worker must have been separated from import-impacted employment and must have worked in import-impacted employment for at least 26 weeks—at wages of $30 or more per week—out of the 52 weeks immediately prior to separation.

Trade adjustment assistance benefits include training, job search and relocation payments, and trade readjustment allowances—which combined with regular unemployment compensation equals 70 percent of the worker's average weekly wage, not to exceed the average national weekly wage in manufacturing, currently $250—for up to 52 weeks, or 78 weeks for older workers or those in approved training. A job search allowance of up to $500 is available to cover 80 percent of transportation and living expenses while a separated worker looks for work outside the place where he lives. A relocation allowance covers 80 percent of moving expenses and provides a lump sum payment up to a maximum of $500.

Since the inception of the program in April 1975, more than $800 million in trade readjustment allowances has been paid to over 500,000 workers. The major beneficiaries have been the autoworkers and steelworkers. Workers in apparel, footwear, and electronics have also figured prominently in the program. The average trade readjustment allowance payment has been $1,600. To date the number of petitions certified under the Trade Act of 1974 is about 2,700. Training, job search and relocation benefits have not been used as extensively as we would like. About 20,000 workers have entered training, while 2,000 workers have received job search payments and 1,000 have relocated.

In Youngstown, Ohio, as a result of the shutdown of Youngstown Sheet and Tube's Campbell Works and layoffs at its Brier Hill Works, about $27 million in trade readjustment allowances was granted to over 8,000 workers. When combined with regular unemployment insurance, the assistance likely exceeded $40 million. Over 400 workers were placed in new jobs, and more than 600 workers received training. About 340 workers were given grants for job search and 200 were relocated. By the fall of 1979, there were 1,500 steelworkers still unemployed.

In Hopedale, as a result of three certifications issued by the Department in 1975, 1977, and 1979, more than 2,100 Rockwell workers received some $6 million in trade readjustment allowances. One worker was given a job search allowance, however, and three were relocated. About 160 workers entered training under the program.

If the subcommittee has any questions, I would be pleased to answer them, either now or following Mr. Batt's prepared statement and Mr. Anderson's comments.

Mr. BEDELL. I think we will hear all the statements first.

TESTIMONY OF WILLIAM BATT, EXECUTIVE SECRETARY, COMMERCE-LABOR ACTION COMMITTEE

Mr. BATT. Mr. Chairman and members of the subcommittee, the Commerce and Labor Departments share responsibility for administering the readjustment assistance provisions of the Trade Act of 1974. While Commerce's responsibility runs to companies and communities, Labor's is for workers. In the fall of 1977, the two departments organized a modest effort at interagency cooperation called the Commerce-Labor Adjustment Action Committee, or CLAAC for short. Its mission was to improve communications between the two agencies, help coordinate their adjustment assistance efforts, and try to improve Government effectiveness in readjustment assistance generally; the same thing you were talking about between HUD and Economic Development.

Some of this committee's accomplishments of the past 2 years have been summarized in a November 1979 report, "Sharpening Government's Response to Plant Closings." Here are a few highlights from that report.

CLAAC has arranged for seminars in regional centers throughout the country in close cooperation with Commerce Department Trade Adjustment Assistance Centers. Companies, mostly small businesses, unions, and State employment security agencies meet together to discuss the program, raise problems and make suggestions for improvement. Over 1,500 people have participated so far in seminars in Los Angeles, San Francisco, Seattle, Chicago, Atlanta, New York, St. Louis, and Providence. Seminars are planned for Cleveland in March and Dallas in June.

Experiments in improving on-site coordination of adjustment assistance for workers have been tried in Buffalo, N.Y., when Bethlehem Steel closed in late 1977, and in four towns in Washington, Idaho, and Utah when the U&I Sugar Co. closed four refineries in 1978 and 1979. About 3,000 people were laid off at that time.

"A Guide for Communities Facing Major Layoffs and Plant Shutdowns" has been prepared and is being distributed widely. I would note that copies have previously been provided to the subcommittee staff. This is a checklist of suggested actions to be taken by the mayor, the plant management, the union, and the employment office manager in any hard-hit community. The guide is based on the experience of many communities which have gone through plant closings in the past. The appendix includes brief descriptions of Government programs of Commerce, Labor, and other agencies such as the Small Business Administration and the Department of Housing and Urban Development which may prove helpful to communities that have been hit with this kind of thing.

One thing we have observed is that no two plant closings are alike. Also, the situation for every worker is unique. The difficulty of readjustment depends on factors like the tightness or looseness of the particular labor market—in Youngstown, it is one thing; in Torrance, it is 3.2 percent unemployment, and with the number of jobs around, it is a very different thing—the provisions in union contracts regarding transfer rights, severance pay, moving allowances, supplementary unemployment benefits, retirement, health benefits, workers' eligibility for trade adjustment assistance, age, years of service, skill level, and a number of other considerations. This uniqueness means that every plant closing needs its own plan of action, locally developed and locally implemented.

The plan of action can best be developed by those most directly affected. Labor, management, and State employment security agencies should get together immediately to assess the impact, and design and implement a plan to expedite the readjustment process. Where the impact is communitywide, as we saw in Iowa, the mayor, local CETA administrators, the Chamber of Commerce and other helpful agencies should be included.

The actions of such a coordinating committee should be designed to: Prevent, delay, or minimize mass layoff; help maintain or replace workers' loss of income; help in reemploying of laid-off workers; help arrange for retraining for those workers who require it to obtain another job; and help rebuild the economic base for the community.

I have put these in this kind of order because this is roughly the way it happens. If a new company could absorb all the workers, that would not apply on the list.

Details of each of these five areas of action are spelled out in the guide, as are checklists for the union, management, and the employment security agency.

We are trying out many of these suggestions right now in a CLAAC steel task force set up in December by Commerce and Labor at industry and union request. Triggered by the November announcements by United States Steel and Jones & Laughlin of plant closings and layoffs in 15 communities in 8 States, affecting 14,500 workers, this group is in the process of assessing the dimensions of the problems created by these closings at each location and seeing that existing private and public adjustment assistance programs are working.

If the subcommittee has any questions, I would be pleased to answer them.

Mr. BEDELL. Thank you, Mr. Batt.

Mr. Anderson, do you have a prepared statement?

TESTIMONY OF ROBERT ANDERSON, ADMINISTRATOR, OFFICE OF COMPREHENSIVE EMPLOYMENT DEVELOPMENT, DEPARTMENT OF LABOR

Mr. ANDERSON. No, I do not.

My purpose here today is to briefly point out to the subcommittee the way in which the CETA could be of assistance. Unfortunately that assistance is remedial as are many of the training and assistance programs.

To cite several examples as to how the CETA program can assist workers dislocated as a result of plant shutdowns, there is a situation in Chicopee, Mass., where the Uniroyal Rubber Co. tire plant has begun a gradual phasedown with closure in approximately 6 months. The reason is the drop in domestic car sales and concurrent drop in tires purchased by auto manufacturers. Part of the problem is the increased sales of foreign cars. Affected will be approximately 500 white collar and 1,100 production workers.

A statewide task force has been established consisting of 16 organizations including the Governor's office, the Commission on Commerce and Development, Office of State Economic Development Director, West Massachusetts Employment Service Office (Al Sydlo, director), Hampden County Manpower Consortium (Frank Gulluni, director), Chamber of Commerce, and others. The most recent meeting was held on January 31 at the office of Mayor Kumor of Chicopee.

It was ascertained that approximately 500 employees were eligible for retirement, another 300 have skills allowing their immediate access to other manufacturing plants (welders, forklift operators, et cetera), and 200 to 300 will relocate to other Uniroyal plants nationwide. The remaining approximately 500 will need assistance. The Hampden County Manpower Consortium is currently operating a highly successful skill training center which can handle about 2,000 trainees each year with training in sheet metal, welding (mig, tig, arc), electronics (assembly, test technician, computer technician), machine operators levels 1, 2, 3 (tool and die). According to Frank Gulluni they have a placement rate of approximately 90 percent. To date the DES has referred 15 applicants (TAA and CETA certified) and they are being processed.

In a recent issue of the Baltimore Sunpapers, the National Can Co. announced that its Baltimore plant would be closing sometime in the spring of 1980. Total employment at the plant is 90. The reason for closure is that this facility produces "hard" cans for the soft drink/beer industries and those industries are now ordering only the newer, soft, crushable cans. The cost of conversion to the newer process was not considered cost effective. When the article appeared, the local Private Industry Council (PIC) in conjunction with the local prime sponsor, the Baltimore Metropolitan Manpower Consortium, contacted the plant manager. The information they received was that 60 of the employees would be retired, but the problem was with the remaining 30 employees. After a discussion of the services available through the prime sponsor, the plant manager agreed to offer the prime sponsor's services to the 30. These employees will be advised of the job-retraining programs available and the job placement services which are rendered through the network of manpower service centers located throughout the metropolitan area. Initial contacts will be coordinated through the PIC with the prime sponsor rendering the actual employment and training services including job search, referrals, and the development of individual contracts for job retraining and placement services rendered through the network of the CETA program in that particular community.

The CETA program as a result of the 1978 amendments now has available to it a new tool that may be of some assistance, and that is our Title VII or private sector initiative program.

As you know, under Title VII, communities are required to have in place a Private Industry Council mandated by law to have 50 percent business and industry individuals, and the balance of that council can be made up of community individuals, organized labor, et cetera.

That Private Industry Council constitutes a bridge between the private sector and the federally sponsored manpower agency in that community.

The council is controlled by the business interests in that community. There is a central place where employers can go to seek assistance as it relates to training workers, finding new employment situations for workers, or providing other kinds of assistance.

You heard earlier from the gentleman from HUD in which mention was made of the Interagency Coordinating Council. One particular activity now underway as a result of this activity is the employment initiatives. There was a question raised as to how we bring programs together at the local level. I think the employment initiatives is one way we get at that problem. The Interagency Council, given its deliberations between the Assistant Secretaries who sit on it, have agreed to enter into a contractual relationship which forces a marriage between CETA, which has entered into bilateral agreements with SBA, with HUD, with the Farmers Home Loan, Economic Development Administration, Department of Commerce, with UMTA—the transportation office—and several other Federal agencies to provide for specific set-asides of jobs that are created as a result of economic development activities. These have been spawned by many of those Federal agencies.

For instance in the case of the Economic Development Administration, which entered into agreement with them, that 15 percent of all jobs generated as a result of economic development activity should be set-asides for occupations for the structurally unemployed in those communities. So if as a result of a HUD activity, a UDAG, a hotel was to be built in a community, the CETA prime sponsor in that community would have access to an employment plan that would provide for 10 to 15 percent of the jobs to be created as a result of the hotel going up, to be assigned to structurally unemployed individuals in that community. This constitutes the making of a marriage in the utilization of Federal funds which I think takes the society a long way with regard to full utilization of the expenditure of Federal dollars.

In this case the UDAG generates a hotel which will foster employees who will pay taxes which will eventually be utilized in the form of further grants. That is an example of how the plan can get at the modality of assistance in regards to plant closings.

That concludes my testimony.

Mr. **Bedell.** Thank you. We appreciate your testimony and we especially appreciate the fact that you waited around all morning to be with us.

Mr. Batt, you indicated each situation is unique, and Mr. Anderson, you mentioned the tire plant closing. How much coordination is there between the different agencies involved? Certainly there is a possibility that the Government could have been making grants to Goodyear Tire and Rubber, in effect, through the people, which then enabled them to increase their share of the market. This could have resulted in the closing of a Uniroyal plant at the time when the Goodyear plant opened; resulting in dislocation of people from the Uniroyal plant.

Do we look at the problems of having an industry coming into a community as to how it will affect other communities? There was a case in my district of a large factory moving from one community to another partly because of the attraction given it by the second community, which caused problems in the community from which it moved.

Mr. **Batt**. Mr. Chairman, there is a long history of this in economic development work. The legislation for EDA and for ARA before that quite clearly specified that no grants or no loans of any kind could be made to help relocate an industry from location A to location B. I am not familiar with the HUD legislation, but I am very familiar with the EDA legislation. Congress made it quite clear. There is no possibility of that happening in the way their legislation runs.

Mr. **Bedell**. You believe as far as Federal legislation——

Mr. **Batt**. As far as Commerce and EDA legislation. I am not sure about HUD legislation.

Mr. **Bedell**. The purpose of these hearings is to look at the impact on the communities, and that is what the Labor Department has to address. You can only address it in cases, as I understand it, of loss of jobs because of import competition. I have to assume there are equally distressing situations where the cause is not import related. Would you care to comment on that?

Mr. **Fooks**. Probably there are more community impact situations not covered either directly or indirectly under this program. We deal from time to time with one-industry communities or with firms that provide substantial jobs to the local community, and when they have to close it does affect the entire community.

Mr. **Bedell**. If that were to occur in a situation that did not involve imports, you could not help?

Mr. **Fooks**. Not through trade readjustment allowances, but through the mechanism of the interaction that Mr. Batt suggested. Where we are cognizant of a problem area we will try to focus in on the community by assisting the community as to how to obtain assistance. But again the trade adjustment assistance program and trade readjustment allowances would not apply in that case.

Mr. **Batt**. When a shutdown is announced initially, a major shutdown, nobody knows whether it is trade related until they make an application and an investigation takes place and that finding is made. It may be quite possible for us to get into a situation thinking it may be trade related, then it might turn out the finding is not trade related. Meanwhile in particular ones we have tried to concert the efforts of the Federal agencies and State agencies concerned under this CLAAC, Commerce-Labor Adjustment Action Committee machinery.

Mr. **Bedell**. Over in the Senate, where I was testifying the other day, there is some indication that United States Steel is likely to close some plants there in Youngstown.

Mr. **Batt**. They have announced they will.

Mr. **Bedell**. There were some statements implying United States Steel has refused to sell that facility to employees if employees raised the money to buy it.

Are you or any Government agencies in a position—I presume this will be costly to the taxpayers as well as the community if it is closed down—to do anything about that at an early enough stage. Do you know of any agencies that could see if indeed the employees, the community, or anyone else were to make a reasonable offer that would keep the plants from being closed down and prevent all this dislocation?

Mr. **Fooks**. We have been meeting with representatives of United States Steel since shortly after United States Steel made the announcement they were going to close 13 facilities around the country.

In our preliminary assessments of the situation where there might be community impact, we came to the same conclusion that other people have come to, that it would be of great value if the communities had access to the facilities being shut down. We have made this known to the corporate officials, but we have no authority to compel them to release or sell these facilities to the communities involved. We can urge them and tell them it would be to the advantage of the adjustment effort, but it is up to them as to how they dispose of the facilities.

Mr. **Bedell**. Is the White House aware of this problem?

Mr. **Fooks**. I believe they are.

Mr. **Bedell**. I think these are the facts: Steel companies complain they are unable to compete with foreign steel; these same steel companies have been making most of their investments in other outside activities; they then refuse to sell the facilities they are closing down to others who would try to operate these facilities and enable us to produce our own steel, and hopefully become more competitive in world markets, I cannot imagine us not having a policy that says it is in the national interest to see that is not permitted. If indeed it is permitted, it is going to be a heavy burden to the taxpayers as well as a burden to the society in the communities where those plants are located.

Mr. **Fooks**. I do not want to presume to be sitting in judgment of United States Steel. They do have a real estate operation which apparently is successful in developing their own properties for nonsteel purposes.

Mr. **Bedell**. The facts I stated are all documented. Nobody disputes those reasons, do they?

Mr. **Fooks**. Presumably if they got a good enough price they would sell, but we do not know what their intentions are. They may have plans to develop them themselves.

Mr. **Bedell**. What should we do in our society, if we have a society where, first of all, it is claimed by one segment, the steel industry, that they are unable to compete with foreign competition, and it is further documented instead of reinvesting their money into their companies they are taking that money and putting it into other ventures? And indeed what should we do if it is true that they are closing plants and not making those plants available to others who would like to upgrade them to make them more competitive with foreign steel? What changes should we have in our economic policy, because surely that is not in our best national interest to have that occur?

Mr. **Fooks**. That is beyond my field of knowledge. We do not know what the corporation intends to do with those facilities. Conceivably they can develop them more rapidly than a government agency could and they could create the jobs we want in these communities.

Mr. **Bedell**. What do you mean develop jobs?

Mr. **Fooks**. They do have a real estate service which may create shopping centers or light industrial sites which they might lease or rent to other corporations. If they do that they are doing essentially what a community development operation would seek to accomplish in any event. We just do not know.

But we do know it is essential that the sites not being put to productive use be put to practical use at the earliest opportunity.

Mr. **Bedell**. I think you are probably right that you folks are asked to come in and help after the problem occurs. My belief is that we may be putting too much attention on you folks rather than working at eliminating the problem and thus eliminating your jobs.

Mr. **Fooks**. Now that you put it in that light, I will express more of an interest.

It is complex. People have been studying the problem for years, and there are aspects on which there is no consensus. There has to be agreement as to what a development plan will be; this all has to interface with the competitive situation. It is easier to do these things in an expanding economy. All I am saying is that it is a difficult problem and it takes a lot of talent to work on it and mutual efforts to resolve any situation.

Mr. **Batt**. Mr. Anderson's story about Chicopee is a typical case of the business of advanced notice.

The auto workers have in their negotiations a 6-month advanced notice provision. The State in this case, obviously was concerned and provided leadership, they had had their problem and were focusing in on that particular problem of that particular group of employees in Chicopee, Mass., which is different from other rubber plant closings and steel and auto plant closings, because of the labor market situation there. The configuration of that labor force as, Mr. Anderson pointed out, is quite unique.

One moral to be taken from that is you have to have that kind of local planning which I think we can encourage more than we do, and you have to have the advanced notice to do the local planning, including the great story we heard from Iowa this morning.

Mr. **Bedell**. How would you feel about legislation which mandated that no industrial plant employing 500 or more persons could be permanently closed without 1 year's notice unless the management of that plant could show cause as to why they should be permitted to close at an earlier time?

Mr. **Batt**. Officially, the Department can take no position. But I would like to see it done in collective bargaining.

Mr. **Fooks**. As Mr. Batt indicated, we are in no position to provide an official opinion.

Mr. **Bedell**. I recognize that. But it is a problem.

Mr. **Fooks**. Yes.

Mr. **Bedell**. What would be the arguments against such legislation?

Mr. **Fooks**. I think part of the argument of the opponents of the legislation would be the concern they will lose the personnel essential to the continued and orderly operation during the 1-year period.

Mr. **Bedell**. If you are going to close it, you will fire them anyway.

Mr. **Batt**. Another reason is, their lines of credit will be endangered, paticularly small companies. They may be forced to go out of business earlier than they otherwise would have to.

Mr. **Bedell**. I said a plant employing over 500 people; I do not care what number you use.

Mr. **Batt**. There are a series of arguments against it which I have heard.

Mr. **Bedell**. At least you believe where there is an opportunity to have some time, both the adjustment can be more readily made and certainly alternative means of keeping the plant open would be enhanced.

Mr. **Batt**. No doubt about it. I think the Chicopee case indicates that.

Mr. **Bedell**. Does staff have any questions?

Mr. **Rosenberg**. I do have a question which arose out of the staff inquiries that preceded these hearings, Mr. Chairman. We had an opportunity to meet with some of the people from Hopedale, Mass., involved in the plant closing there. One of the things they told us in private, because individuals did not want to come forward and be identified in a public hearing, is that here is a situation where trade adjustment money was being used to provide continued income to workers who had been displaced, and in the process of trying to reopen the plant they looked around and saw one of the assets of the community was a large number of unemployed people which should depress the cost for labor in the community. So they went out and made a wage offer better than the minimum wage to encourage some of these unemployed workers to come in and do maintenance work, primarily.

Apparently what they were able to pay for maintenance workers was less than the workers were receiving under the trade adjustment funding. I believe they did get some workers to agree to come out of the trade adjustment money and accept the jobs at a lower income level.

Are there are any provisions within the trade adjustment program which would require workers to accept employment if it were offered but at a lower wage?

Mr. **Fooks**. Generally, the State agencies which administer the program for us all have a common policy that if a worker refuses suitable employment, he is to be disqualified for the trade readjustment allowance and also for unemployment insurance, I believe, if that applies.

The question is, What is suitable employment? It may not be unreasonable for workers who have been employed at $8 or $9 an hour to refuse a job at the minimum wage or slightly above. It depends on how long they have been unemployed. If there is absolutely no alternative for them, this may be suitable employment. This is a difficult problem, and the equities are considerable.

Mr. **Rosenberg**. I was surprised when we made the first staff contacts with the Labor Department and indicated the subcommittee's interest to find out what sort of statistics existed on how many jobs had been gained or lost as a result of conglomerate mergers, how many jobs had moved from one community to another as a result of plant acquisitions or mergers, and we were told the Labor Department did not have figures that could respond to those problems. That was a surprising response, and I was wondering if you could comment on that.

Mr. **Fooks**. I cannot. I guess the Bureau of Labor Statistics has not seen fit to assign or study employment trends as to cause and effect. They do not, to my knowledge, study specific employment trends because of losses to import competition or any other specific event. I believe they can probably outline which way—what the trends of employment are by geographic area, why employment is increasing in the South and decreasing in the North, they might be able to give you some general reasons as to why that is occurring, but whether they might be able to assign any particular segment to merger policy or imports or whatever, I do not think they can do that.

But we will try to provide the subcommittee with something that is useful.

Mr. **Rosenberg**. I do not claim any expertise in the Labor Department, but we would be surprised if the HEW came in and said they only count the number of dead bodies but not what the cause of the illness is; if we are keeping statistics on the number of unemployed but not the cause, we are not doing a full job.

Mr. **Levine**. Very interesting statistics have come from the SBA about job creation. It would be interesting to know if the Department of Labor has the same kind of data collection process. It would certainly help in the development of a national economic policy.

Mr. **Fooks**. We will certainly try to come up with something the subcommittee can use. We would like to have what the SBA comes up with so we can review that and perhaps comment on that.

[The information submitted by Mr. Fooks follows:]

Bureau of Labor Statistics

Trends in Nonagricultural Establishment Employment

1973-1978

1. The Southwest, Mountain and Northwest regions have had the highest employment growth rates. The strong employment growth there can be largely attributed to growth in the service sector which expanded more rapidly than other segments of the economy.

2. Employment continued to shift away from the Northeast and Midwest regions towards the Southwest and far West. Growth rates in the Southeast region decreased from the period 1948-73, but remained close to the national average.

3. The service-producing sector accounted for 93 percent of the Nation's employment growth in 1973-78 and in 1978 accounted for over 70 percent of the Nation's nonagricultural employment.

States. From 1948-78, the annual average rate of nonagricultural employment growth in the United States was 2.2 percent. During that period, Nevada (6.5 percent), Arizona (6.0 percent) and Florida (5.3 percent) had growth rates that more than doubled the national average. West Virginia (0.4 percent), the District of Columbia (0.6 percent), Pennsylvania (0.8 percent), New York (0.8 percent) and Rhode Island (1.0 percent) all had growth rates that were less than one half of the national average. Also during this period, almost all of the States whose employment growth was less than the national average were located in the Northeast and Midwest regions of the country. In contrast, all of the States with growth rates greater than 3.0 percent were located in the Southern and Western regions of the country.

During the more recent 1973-78 span, nonagricultural employment grew at an annual rate of 2.4 percent. In contrast to the 1948-78 period, nine States had growth rates that more than doubled the national average. Of those States, Wyoming (8.4 percent), Alaska (8.4 percent), and Nevada (7.4 percent) had the highest growth rates. New York (-0.3) and Delaware (0.6) had the smallest growth rates during the 1973-78 period. Since 1973, almost every State west of the Mississippi and four Southeastern States had growth rates greater than the national average. In contrast, of the 17 States with growth below the national average, almost all were located in the Northeast and Midwest regions.

Industry Composition. The service sector (defined as transportation and public utilities, wholesale and retail trade, finance, services and government) grew significantly in terms of employment during the 1948-78 period. The service sector represented 58 percent of the total nonagricultural employment in 1948, 68 percent in 1973 and 71 percent in 1978. The strongest growth occurred in the major divisions of services, trade, and local governments.

During the 1973-78 period, most of the Nation's employment growth occurred in the service sector. The rate of growth in that sector was nearly 10 times greater than the rate in the goods producing sector.

Table 1.

Total Nonagricultural Growth Rates for Selected Years

States	Annual Rates of Growth 1948-78	Rnk	Annual Rates of Growth 1973-78	Rnk
Alabama	2.5	26	3.3	20
Alaska	n.a.		8.4	2
Arizona	6.0	2	4.3	10
Arkansas	3.1	15	3.4	19
California	3.6	6	3.9	15
Colorado	4.0	5	3.9	14
Connecticut	1.9	38	1.7	38
Delaware	2.6	25	0.6	49
District of Columbia	0.7	48	0.6	50
Florida	5.3	3	2.5	32
Georgia	3.2	12	2.0	36
Hawaii	n.a.		2.7	30
Idaho	3.3	10	5.6	4
Illinois	1.3	43	1.3	47
Indiana	2.0	37	1.6	42
Iowa	2.1	34	2.8	28
Kansas	2.4	29	3.6	18
Kentucky	2.7	22	3.3	21
Louisiana	2.8	18	3.8	17
Maine	1.4	42	2.7	29
Maryland	2.8	19	1.6	41
Massachusetts	1.2	44	1.5	43
Michigan	1.8	39	1.5	44
Minnesota	2.5	27	3.2	24
Mississippi	3.3	9	3.2	23
Missouri	1.7	40	1.7	39
Montana	2.2	31	4.3	11
Nebraska	2.2	33	2.1	35
Nevada	6.5	1	7.4	3
New Hampshire	2.5	23	4.0	13
New Jersey	2.0	36	1.5	45
New Mexico	4.1	4	5.1	6
New York	0.8	46	-0.3	51
North Carolina	3.1	13	2.3	33
North Dakota	2.7	21	4.8	9
Ohio	1.5	41	1.3	46
Oklahoma	2.7	23	3.8	16
Oregon	2.8	17	4.3	12
Pennsylvania	0.8	47	0.7	48
Rhode Island	1.0	45	1.7	40
South Carolina	3.1	14	2.9	27
South Dakota	2.3	30	3.1	25
Tennessee	2.8	20	2.2	34
Texas	3.5	8	4.8	8
Utah	3.6	7	4.8	7
Vermont	2.2	32	3.3	22
Virginia	3.2	11	3.0	26
Washington	2.6	24	5.4	5
West Virginia	0.4	49	1.8	37
Wisconsin	2.1	35	2.5	31
Wyoming	2.9	16	8.4	1

Footnote: Ranks based on unrounded data.
Source: Bureau of Labor Statistics
n.a. = Not available

Table 2. Annual Average Rate of Nonagricultural Establishment Employment Change by Region 1/

Region	1948-78	1973-78
Boston	1.5	1.8
New York	1.1	0.2
Philadelphia	1.4	1.4
Atlanta	3.4	2.6
Chicago	1.7	1.6
Dallas	3.3	4.4
Kansas City	2.4	3.2
San Francisco	3.6	4.2
United States	2.2	2.4

1/ Regions correspond to the Bureau of Labor Statistics eight administrative regions listed below.

Source: U.S. Department of Labor
Bureau of Labor Statistics
January 1980

Boston Region

Connecticut
Maine
Massachusetts
New Hampshire
Rhode Island
Vermont

Atlanta Region

Alabama
Florida
Georgia
Kentucky
Mississippi
North Carolina
South Carolina
Tennessee

Dallas Region

Arkansas
Louisiana
New Mexico
Oklahoma
Texas

San Francisco Region

Alaska
Arizona
California
Hawaii
Idaho
Nevada
Oregon
Washington

New York Region

New Jersey
New York

Philadelphia Region

District of
Columbia
Delaware
Maryland
Pennsylvania
Virginia
West Virginia

Chicago Region

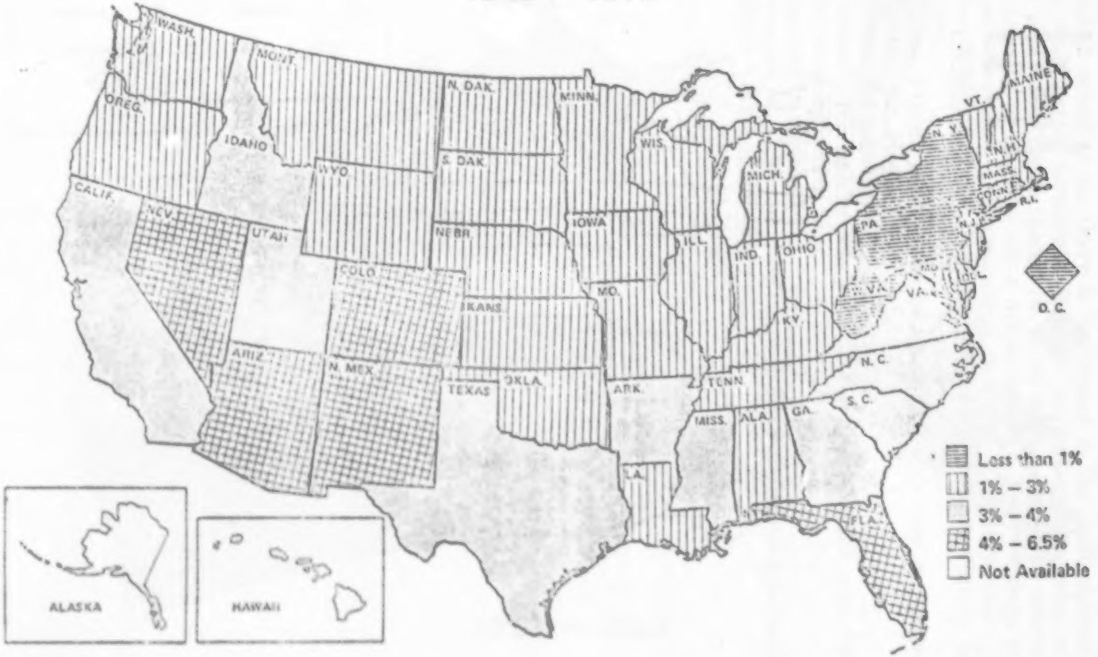
Illinois
Indiana
Michigan
Minnesota
Ohio
Wisconsin

Kansas City Region

Colorado
Iowa
Kansas
Missouri
Montana
Nebraska
North Dakota
South Dakota
Utah
Wyoming

TOTAL NONAGRICULTURAL EMPLOYMENT GROWTH RATE* BY STATE

1948 – 1978

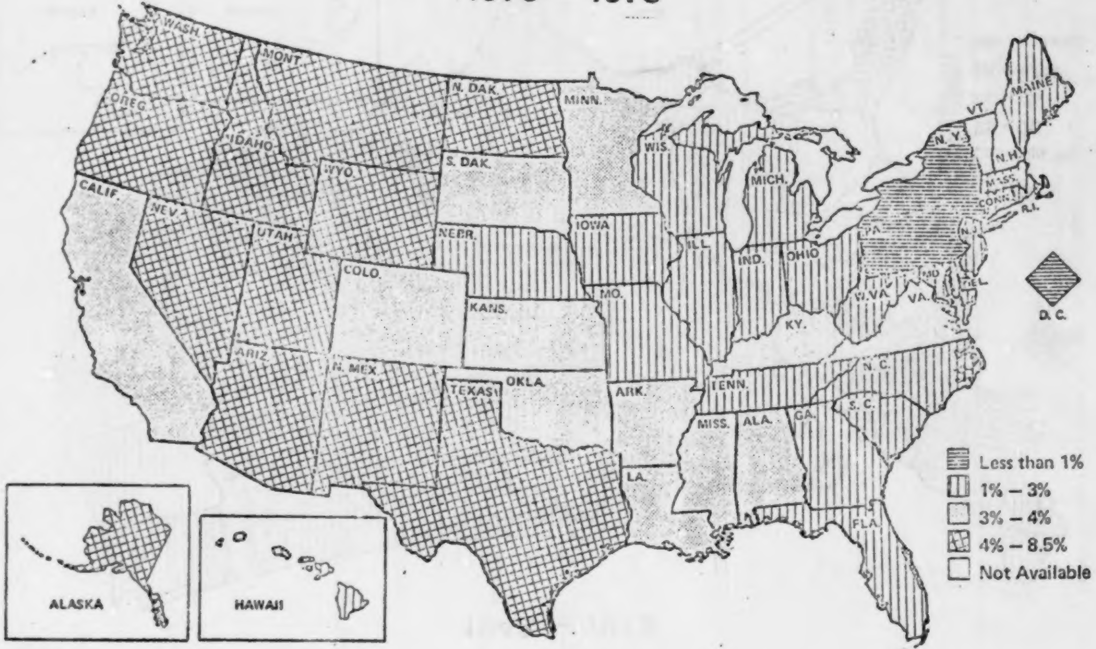

WASH.
OREG.
CALIF.
MONT.
IDAHO
NEV.
UTAH
WYO.
COLO.
ARIZ.
N. MEX.
N. DAK.
S. DAK.
NEBR.
KANS.
OKLA.
TEXAS
MINN.
IOWA
MO.
ARK.
LA.
WIS.
ILL.
MICH.
IND.
OHIO
KY.
TENN.
MISS.
ALA.
GA.
FLA.
S. C.
N. C.
VA.
W. VA.
PA.
N. Y.
VT.
MAINE
N.H.
MASS.
CONN.
R.I.
N.J.
MD.
DEL.
D. C.
ALASKA
HAWAII
▤ Less than 1%
▥ 1% – 3%
☐ 3% – 4%
▦ 4% – 6.5%
☐ Not Available

*Annual Rate

best copy available

TOTAL NONAGRICULTURAL EMPLOYMENT GROWTH RATE* BY STATE

1973 – 1978


WASH.
OREG.
CALIF.
MONT.
IDAHO
NEV.
UTAH
WYO.
COLO.
ARIZ.
N. MEX.
N. DAK.
S. DAK.
NEBR.
KANS.
OKLA.
TEXAS
MINN.
IOWA
MO.
ARK.
LA.
WIS.
ILL.
MICH.
IND.
OHIO
KY.
TENN.
MISS.
ALA.
GA.
FLA.
S. C.
N. C.
VA.
W. VA.
PA.
N. Y.
VT.
MAINE
N. H.
MASS.
CONN.
R.I.
N.J.
MD
DEL.
D. C.
ALASKA
HAWAII
Less than 1%
1% – 3%
3% – 4%
4% – 8.5%
Not Available

*Annual Rate

Mr. **Bedell**. The subcommittee wants to see figures such as that developed, it seems to me there is legitimacy to the staff argument that we could better formulate policy if we better knew what was causing problems. There should be more knowledge as to whether merger activity or imports are a major cause of plant closings and just what the other various causes may be. Certainly they are expensive to remedy once they have occurred. Your testimony has shown that.

Mr. **Fooks**. I think that would be an appropriate way to proceed.

Mr. **Bedell**. Ms. Hoppe.

Ms. **Hoppe**. No questions.

Mr. **Bedell**. We appreciate your being here. Thank you very much for your testimony.

The hearing is adjourned.

[Whereupon, at 12:05 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

blank page

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

TUESDAY, FEBRUARY 12, 1980

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2359-A, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. BEDELL. The subcommittee will come to order.

The Subcommittee on Antitrust and Restraint of Trade today is continuing its study on conglomerate mergers and their effects on small business and local communities. This is the fifth in our month-long series of hearings on this subject. Our witnesses today are an outstanding group of academic experts who have studied conglomerate mergers and related events from a variety of perspectives.

We understand that there is a wide range of opinions and viewpoints represented here, and we look forward to dialog not only between the members of this subcommittee and our guests but also among the witnesses themselves.

We are especially pleased to note that several of today's witnesses recently have completed original research efforts on which they will be making their first public reports this morning. The subcommittee appreciates their making this information available to us in such a timely fashion.

As always, we encourage all of our witnesses to summarize their statements, submitting longer prepared remarks or supplemental material for inclusion in the printed record. If there are no objections, the record will be left open for written testimony from several economists who were invited to appear here today but whose schedule prevented them from delivering their statements in person.

[These statements can be found in appendices DD, EE, and FF.]

Our first panel today consists of Barry Bluestone, a professor of Boston Univeristy, and Bennett Harrison, a professor at the Massachusetts Institute of Technology. They have jointly authored a major new study on economic dislocations caused by plant closings.

A portion of their research specifically focused on economic activity associated with mergers, and we understand that their testimony today will present their findings on this topic.

Mr. Hanley, do you have a statement that you would care to make?

Mr. **Hanley**. Not at this time, Mr. Chairman.

Mr. **Bedell**. Mr. Tauke?

Mr. **Tauke**. Thank you very much, Mr. Chairman.

On behalf of the minority, I would like to again congratulate you on arranging a very fine hearing for today.

So far, we have studied mostly specific cases that have developed across the country in relationship to conglomerate mergers. Today we will take a broader look at the issue, and I am looking forward to the testimony.

Mr. **Bedell**. Thank you very much.

PANEL CONSISTING OF ECONOMISTS: BARRY BLUESTONE AND BENNETT HARRISON

Mr. **Bedell**. Would Mr. Bluestone and Mr. Harrison please come forward?

We have a practice of swearing in our witnesses. Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Bluestone**. I do.

Mr. **Harrison**. Yes, I do.

Mr. **Bedell**. You may proceed in whatever manner you wish. If you have a prepared statement, you may either read it or summarize it. We have four panels today, so we would appreciate anything you can do to help us save time.

TESTIMONY OF BENNETT HARRISON, ASSOCIATE PROFESSOR OF ECONOMICS AND URBAN STUDIES, DEPARTMENT OF URBAN STUDIES AND PLANNING, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MASS.

Mr. **Harrison**. Thank you, Mr. Chairman.

We are going to try to do in our prepared remarks three things: Talk briefly about some of the aggregate statistics on closings and the relocation of capital directly connected with conglomerate ownership; to talk with you a bit about some of the case material you have heard from others, and introduce some of the material you have probably not heard yet, including material that has been prepared recently by researchers at Harvard University who could not be here today but have authorized us to discuss some of their work; and then to conclude the prepared remarks by summarizing some very extensive work we have been doing on the social consequences for workers and their communities of plant closings, particularly connected to absentee or what is often called remote control of local business by conglomerate owners.

Let me start with probably the most general kind of description I can, and then we will work our way back down to specific cases.

Let me take one particular industry for illustration, which is of great national interest—the transportation equipment industry, the industry that makes anything from automobiles, to engines, to engine parts, to retail vehicles, airplanes, and so forth.

During the period of the 1970's, to give you a sense of the magnitude of the shifts in location of industrial activity in this one sector alone, over 23 percent of the new acquisitions of companies operating in this particular sector in the country were in the southern and mountain States. Let me stop and give you a benchmark for that. At the beginning of the 1970's, only 18 percent of all the plants in the United States of America producing transportation related equipment were located in the Sunbelt. During the 1970's, over 23 percent of those companies new acquisitions were in the South, about half of the new branch openings were in the Sunbelt; only 14 percent of those Southern and Mountain States existing plants were physically cut back, experienced disinvestment during the decade, but 70 percent of their northern plants in that industry experienced disinvestment or cutback.

Finally, while about 27 percent of those pre-existing—that is, the beginning of the 1970's—southern or mountain plants were closed over the period, nearly twice as many were closed in the Northeast and North Central States. The differences are just extraordinary.

Thanks to research that we have been able to engage in based on data from the Dun & Bradstreet Co. prepared by another of the witnesses you are going to meet in a while—my colleague from MIT, Dave Birch—we have been able to study the particular impacts of closings by form of ownership in the New England area for the period 1969 through 1976.

In a nutshell, over that period of time, we estimate a minimum of about 100,000 closings, carrying with them a lost of about a million jobs. About 15 percent of the actual business closings were small businesses, as one would expect. The small business sector experiences overwhelmingly high turnover; lots of openings and lots of bankruptcies.

However, although only about 15 percent of all of those business closings in New England in that period were in the corporate and conglomerate, as opposed to independent small business, sector of the economy, half of those million jobs were lost as a result of those closings.

The point there, I think, is the disproportionate impact of a closing that occurs when it is a closing in the corporate and conglomerate part of the economy.

The likelihood that a business will close over a period of time depends very much on size of business. In all sectors of the economy—manufacturing, trade, and services—and in all regions of the economy—Northeast, North Central, South, and West—the probability that a business that exists at any point in time will close down in this particular example 6 years later declines the larger the company. Small businesses have the higher probability of going out of business. But, again, the impact on employment lost to a community is so overwhelmingly the other way, a single very large closing, or the closing of a large family business which has been acquired by a conglomerate—we will have lots of case examples of that for you in a moment—means that the employment lost to the community will be disproportionately large if it is a closing in the corporate sector.

Let me now give you some examples of what, so far in our work and from the reactions we have got on this work from other people we have spoken with, we have found to be the most dramatic discovery; we had not expected this. We have studied 10 specific industries in New England over this period of 1969 to 1976, and the question we have asked is this: For every 1 plant or new business opened during that period, how many were closed; and what was the rate of closings to openings for conglomerates, through the acquisition and divestiture process, for the branch plants of corporations, and, of course, for small business?

The ratios are extraordinary, and, in keeping with your agenda today, let me give you the figures for the conglomerate sector. In women's apparel, for every 1 plant opened or acquired—if you can bear with the imaginary statistical notion of averages—about 3½ businesses were closed down; for every 1 opened, 3½ closed down in New England in that period.

In the papermill industry, for every 1 opened 2 were closed down. In the shoe business, for every 1 opened, 2 were closed down. And I emphasize now I am talking about the conglomerate sector; I am not talking about small independent family businesses that lose out because of, say, Italian and Spanish competition.

Mr. **Bedell.** Excuse me; I think you misspoke. For shoes, this chart I have shows 6 closing down for every 1, rather than 2.

Mr. **Harrison.** I did not say 6? I am sorry. That is right—6 for every 1 in the shoe business.

In the aircraft engine and parts industry, which happens to be the single most important manufacturing employer in all of New England—General Electric, Pratt & Whitney, and all of their many subsidiaries and subcontractors, many of which are owned by large conglomerates, and, of course, Pratt & Whitney itself is now the child of one of the largest conglomerates in the country, United Technologies—4½ plants closed for every 1 opened.

The rest of the numbers read similarly: In the grocery store and supermarket business, the "mom and pop's" have their problems, but conglomerate closings and chain closings of grocery stores and supermarkets have ended up, on balance, closing about 3 for every 1 that they opened.

Let us talk for a moment about some specific examples of the ways in which—and our exclusive focus today has not been on conglomerates, but let us talk for a moment about particularly the ways in which the conglomerates, and the reasons for which we think, conglomerates closed viable businesses. That was, in fact, a major object of our work.

It was motivated by a question that, as professors of economics, we felt was a perfectly natural question to start: Why should a profitable business be closed? Is that the way the system works? Is there any reason to expect that a profitable business would be closed down? The answer is, absolutely, positively, yes; the rules of the game have changed radically; it is not the 19th century; we are not talking about competition among small business people who are striving to make the last buck. Indeed, one of our case studies on the metalworking industry in New England, which is overwhelmingly an industry of small, often family run businesses where the owner is himself—usually a "him"—a very skilled craftsman who has built the small business, shows that their ability to weather the business cycle is extraordinary; they will stay in business even if they have to hock their mortgages in order to keep in operation.

On the other hand corporate and conglomerate operations with respect to small business look very, very different. It starts with the finding—and this cannot be a new idea to you, but I set it as the beginning of illustrating the data—that almost all of the companies that we have interviewed ourselves in our interview work—and we have interviewed 220 companies in New England—but also overwhelmingly in the research literature and the business press, it is very clear that the objective of the modern, especially conglomerate group is no longer profit maximization in some kind of very simple way. The objective clearly is growth.

No less an authority than Prof. Paul McCracken, who was President Nixon's Chairman of the Council of Economic Advisors, in a letter to the chairman of the K-Mart Corp., one of the largest discount department stores in the country, said to that gentleman, "Companies which decide to take their ease are apt to be on the road to decay." What he meant, in the context of that letter, was: You have got to continue to grow in order to survive. Growth in order to survive is not the particular modus operandi of many of the small, especially family owned businesses that we have interviewed. Their tendency is to try to find a market share, to try to make enough money to pay the bills, to try to keep a small group of skilled workers employed. The degree of attachment to especially their skilled workers we have found to be extraordinary. None of that exists in particularly this sector of the economy.

One of the ways in which the disinvestment in viable businesses occurs which seems to help to underlie those remarkable statistics we gave you a moment ago have to do with the use of something which textbook economic stories about competition never reveal. That is the notion of target rates of return.

In every one of the industries we studied, ranging from department stores and apparel shops to computers and aircraft engines, at least some of those companies which were divisions or subsidiaries of parent conglomerates were required to meet minimum annual profit targets as a condition for receiving finance or executive perks from the home office. Many branches and previously acquired businesses were ultimately shut down because they could not achieve what the managers of those companies described to us as what the parent companies officers call "hurdle rates."

One of the things we went through in this exercise was a whole new vocabulary lesson. We learned vocabulary we had never heard before. Parent companies refer to acquisitions as "cash cows." When we asked them what they mean by "cash cows," they say they operate them in order to get their cash flow in order to be able to invest in other kinds of operations. The Lykes acquisition of Youngstown Sheet & Tube is probably the most dramatic but by no means the only example.

You know, and you have heard undoubtedly already, and you will hear some more today from some of his colleagues, of the case study work of William Whyte at Cornell University. Whyte shows, for example, that the Herkimer, N.Y., plant producing library furniture had been acquired by Sperry Rand back in 1955. The plant had made a profit every year except one through the next two decades, and yet Sperry Rand decided to close the plant and sell the equipment in part because it was not yielding a 22 percent profit on invested capital. That was the standard used by this particular conglomerate's management in determining an acceptable rate of return on its investment.

You have also heard the case study of Bates Manufacturing Co. which was one of the most important and prestigious New England textile manufactures. After several exchanges of ownership after World War II, all of the mills except the one at Lewiston were sold off to textile conglomerates. The Lewiston facility was then sold also to two New York investors, who, frankly, were more interested in the coal and energy business, which was thrown in as a side piece along with the Bates transaction.

The energy business promised a 15- to 20-percent rate of return on investment. This, of course, is a several-year-old case study; now the number must be three times that. This was in contrast to Bates steady but small 5 to 7 percent return—quite enough to pay off the banks, quite enough to meet the payroll, but not enough to meet the much higher rate of return standard of the parent.

As a long-standing manager of the firm put it in a local interview in Maine, "These boys were not textile men; they were money men; they just understood money." And, sure enough, they decided to close the business in 1977. The jobs were saved only when the mill's workers and some of the former managers chose to buy it through an ESOP arrangement.

In the Lower Pioneer Valley of central Massachusetts, the Chicopee Manufacturing Co. was generating an estimated 12 percent rate of return on its apparel products. The average rate of return on invested capital in the apparel industry nationally is about 8 or 9 percent. This, in fact, was then a relatively highly profitable operation. The parent firm, Johnson & Johnson—hardly known for its apparel operations—was dissatisfied with anything short of a 16-percent minimum and announced that Chicopee would be shut down.

As times change, the hurdle rates themselves get changed by central management. In textiles and apparel, for example, the founder of Textron, a company which I gather has been in the news of late in Washington again, told a congressional investigative committee back in 1948 that his conglomerate generally insisted that each of its subsidiaries earn 10 percent on total invested capital before taxes or risk being shut down. By the late 1970's, according to its own corporate reports, another closing conglomerate, Genesco, which I myself interviewed, was imposing a 25-percent hurdle rate upon its various companies.

Whatever the particular value of the target in a particular company at one time or another, the principle of the corporate hurdle rate means that in this modern era of international high finance, viable businesses can be closed down because, although they may be making a profit, it is not enough of a profit. As one consultant advises his corporate clients, "When the wage bill as a percentage of sale rises or when the rate of return on investment falls below one of these standards, it is time to think about shutting down." This particular very prominent business consultant suggested as a standard rule of thumb about hurdle rates the current money market interest rate. I suspect some of us in this room have some money in the money markets these days, and we know that means about 13.5 percent at the moment. But 13.5 percent is an absurdly high rate if you are talking about the ability to keep a small, medium-sized business going.

Another of the mechanisms by which conglomerates close viable businesses is by siphoning off the subsidiary's profits. An absolutely central mechanism by which any kind of capitalist enterprise traditionally has been able to grow is to make enough of a profit to be able to reinvest in the business, that is, to reinvest in buying new plant and equipment, to reinvest in being able to invest in particular training of more skilled workers, and so forth.

Holding on to your profits is a key way in which a capitalist enterprise grows.

Not only are many corporate branches and conglomerate subsidiaries unable to establish their own performance criteria—as we have just seen—but the profits they do earn are generally repatriated to the parent firm, to be reallocated according to the latter's priorities. We, ourselves, first encountered this phenomenon during our papermill and department store work in New England in 1979.

In one subsidiary of a Fortune 500 company, the profits from its local specialty paper products operation are taken by the parent, which has returned only enough capital to the mill to meet Environmental Protection Agency requirements for environmental cleanup, which is quite appropriate but quite insufficient to enable the enterprise to grow. And I quote from this particular interview:

> In fact, only 5 percent of capital expenditures over the past 5 years have been allowed to go into growth. In that period, net assets have declined 26 percent, and employment in the plant has declined 9 percent. Clearly, this is a case of the corporation operating a division as a "cash cow."

Because the New England market for department store sales is thought by many industry leaders to have become more or less saturated, I quote from another of our interviews with a former vice president of one of the largest and most famous department stores I guess in America, "Local units of national holding companies and department store chains are made to serve as cash cows for stores in other areas of the country where the population is growing."

The appropriation of a subsidiary's or a branch's surplus by the parent corporation introduces an extremely severe structural imbalance into the local business's operations. During years when sales are good, the profits grow and then accrue to the parent; when times go bad, the operating company has been stripped of its reserves; it may be forced to go into the local capital markets for a loan, but lack of control over its own future profit stream makes the servicing of this loan problematical. After all, you pay off a loan out of the profit stream that you are able to generate in future operations. Local banks or other lenders suitably discount this by charging a higher interest rate often; so, local businesses whose flow of capital is controlled by an absentee parent often face another form of discrimination in the local capital markets. And, of course, the parent firm may not even permit the branch or subsidiary to go and try to borrow money on its own since its freedom to do that is sometimes centrally controlled as well.

Thus, by becoming the banker to its various constituent plants or companies, the centralized corporation or conglomerate is able to enforce its growth and other goals. At best, the subsidiaries are forced to compete directly with one another for access to their own profits since the profits get pooled and then individual companies a la "profit center" notion which all of our management schools now teach are required to compete for a share of what were, in fact, their own profits. It is a very strange system.

In fact, conglomerates and, since 1976, more and more large corporations—so that we do not think of conglomerates—like steel, and oil, and so forth, have tended to place the capital so obtained into other often totally unrelated acquisitions instead of reinvesting in the sector, let alone the specific company from which the surplus was redistributed.

Some concrete examples are as follows. In department stores, for example, the managers of K-Mart told us that continuing operations will be throwing off far more cash—so successful is this homegrown company—than its traditional business can profitably absorb. As a result, industry sources estimate that by 1981 probably one-quarter of K-Mart's available cash will probably be going into other kinds of operations.

Yet, at the same time, just to show the chaos and irrationality of the system, Mobil Oil Corp., in a time when we are screaming about the need for more capacity at home in order to reduce our dependence on foreign imports, used a substantial part of its post-1973 inflated international oil profits, not to expand domestic petroleum production, but to purchase Montgomery Ward, one of the largest department store chains in the country.

In much the same way, the steel companies have been using the profits from existing operations, profits enhanced by the savings derived from not reinvesting in new, modern plant and equipment for the existing mills, to acquire nonsteel-related businesses.

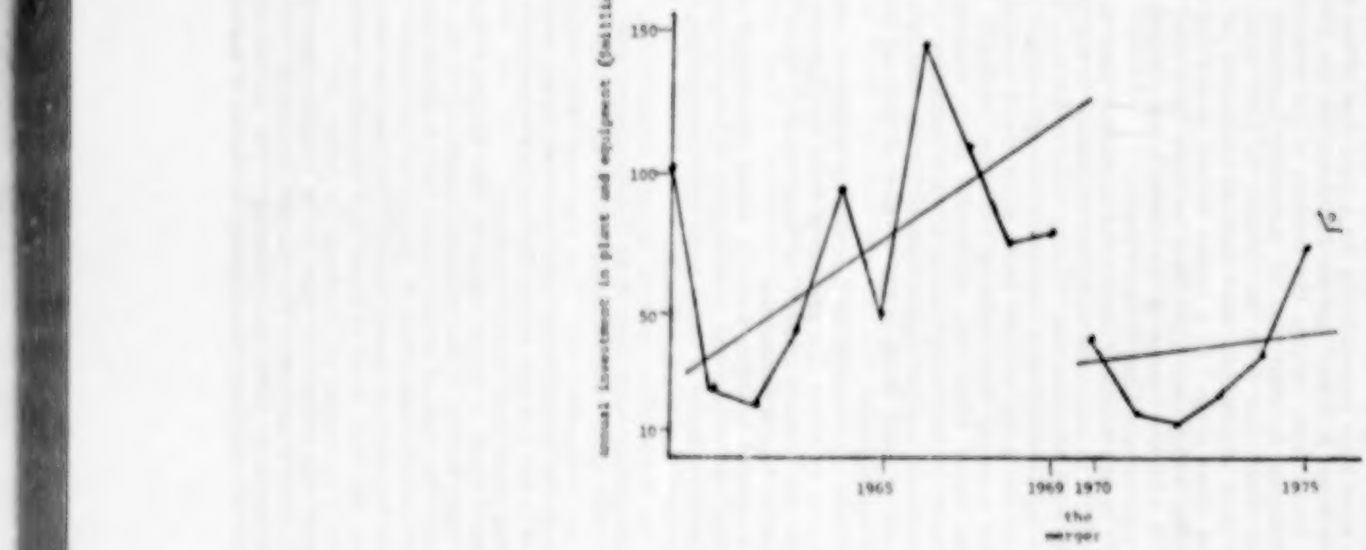
According to United States Steel's annual reports, for example, the company spent only half of its capital investment budget on its steel operations in 1979, down from 69 percent in 1976. Increasingly, they are shifting into chemicals, real estate, and so forth. In fact, in 1979, for every dollar of capital depreciation in nonsteel subsidiaries of United States Steel, the corporation spent $3 in new plant and equipment investment. But in steel making, for every $1 written off, only $1.40 was replaced. This is disinvestment with a vengence.

Probably the most famous modern conglomerate-related plant closing—and you have heard much about it already, but I think we have some new data you probably have not seen—was the 1977 shutdown of Youngstown Sheet & Tube in Ohio. In the handout, which I think you all have, if you turn to page 33(a), you will see that this really is a case where one picture tells an awful lot of words, and so I will keep the words to a minimum and stop talking.

This comes from a case study which has been prepared by Professor Daniels of Harvard University. In 1969, as you well know by now, Sheet & Tube, which was then the Nation's eighth largest steelmaking firm, was purchased by a New Orleans based conglomerate, the Lykes Corp. The acquisition was financed mainly by a major loan package which Lykes promised to pay off out of Sheet & Tube's very substantial cash flow.

[See following chart:]

Investment and Disinvestment in the Campbell
Works of the Youngstown Sheet and Tube Company:
1960-1975



---

a/ investment project undertaken only after two consecutive years of unexpectedly high world-wide demand for steel. Project was abandoned during the 1975-76 recession.

source: Beldon Daniels, et. al., The Treatment of Smaller Firms Under Conglomerate Ownership. Department of City and Regional Planning, Harvard University, September 30, 1979, mimeo, p. 121.

Mr. **Harrison**. During the next 8 years, Lykes used Sheet & Tube's cash to amortize that debt and to expand its nonsteel operations. The figure before you shows, from data from the company, pre- and post-merger annual capital investment in Youngstown Sheet & Tube. Clearly, Lykes was pursuing a pattern of planned disinvestment in its recent acquisition. This pattern has led most financial analysts to agree—and I quote now Business Week magazine—"Lykes must bear responsibility for a good deal of the failure of Youngstown Sheet & Tube," not the Japanese, not the Germans, not mystical forces from outside the borders of the country, but active disinvestment in what was an extremely profitable plant.

As Business Week put it in its October 3, 1977 issue, "The conglomerate steel acquisitions were seen as cashboxes for corporate growth in other areas." In a rather absurb prostscript to the closing, a closing which cost 4,100 Ohio workers their jobs, Lykes merged in 1978 with the owners of the Nation's next largest steelmaker, the conglomerate, Ling-Temco-Vought.

As some of you are probably aware, the argument used in court by Lykes and LTV to overcome antitrust objections to the merger was that their steel business was "failing" and could only be rescued by achieving financial scale economies through merger.

I assume you are going to hear some more about economies of scale later this morning from some of the other panelists. I find history lessons about where the arguments about economies of scale come from to be very enlightening kinds of exercises.

The now-completed merger makes Lykes-LTV the Nation's third largest producer of steel. Such is the history of how an industry becomes more concentrated.

Let me conclude my remarks by mentioning quickly a couple of other mechanisms by which this process of what the industry itself sometimes calls the "remote control" of local industry tends to run down otherwise profitable businesses.

There are a number of other ways in which centralized control by a home office can impair the profitability of a newly acquired branch or subsidiary. Some of these costs have been so great as to actually make the business unprofitable.

Sometimes the home office requires its new acquisition to carry additional management staff sent from headquarters, staff which the subsidiary did quite well without before and which market analysts feel are redundant now. This business about conglomerates having superior management and acquiring firms which are badly managed is not a theme which the business community itself and the business press itself tends to endorse.

For example, I quote a recent issue of New England Business, the principal trade journal of the business community in the region of New England. They talked about a small New England manufacturer—"small"—which controlled 40 percent of the entire United States domestic hypodermic needle model. That may not sound like big stuff to you, but that is one of those high technology companies that the people in my region are banking the future on.

That company was offered for sale by its conglomerate parent which did not want it anymore. The market analyst in New England Business magazine notes the following: "The parent corporation, a Fortune 500 company, has imposed an excess of managerial staff and other requirements, which has added nonproductive costs to the operation. A pro forma" that means a simulated balance sheet—"eliminating this overlay of corporate expenses shows a much better profitable picture."

Recently freed from its former parent, the Esmark conglomerate, the Peabody Tannery in Massachusetts now projects a reduction in overhead and administrative expenses of about one-half million dollars a year.

In 1978, the New England Provision Co. of Dorchester, a Boston neighborhood——

Mr. BEDELL. Excuse me, Mr. Harrison. I am quite concerned about our time. How much more do you have, because we were trying to limit it to 10 minutes and it already has been about one-half hour?

Mr. HARRISON. I am sorry. May I take 3 more minutes.

Mr. BEDELL. Yes. Would you try to cut it short?

Mr. HARRISON. I will do that. Thank you.

Let me come back and try to skip over some of the particular examples and not give you all of them.

In 1978, the New England Provision Co. of Dorchester, a Boston neighborhood, had its meatpacking operations shut down by the same Ling-Temco-Vought conglomerate that recently merged with Lykes. The firm had been consistently profitable prior to its acquisition by LTV in the late 1960's. One of the factors turning profits into losses seems to have been LTV's insistence that NEPCO pay a fee to the parent for management services. This practice was also found to be present in the case of Sheller-Globe's acquisition of the Colonial Press. You have heard of that whole $900,000-a-year management fee business from other witnesses, I believe, in the last few days, so I will not repeat that.

In the NEPCO case—the one I have just told you about—not only was there a management fee problem, but the firm was required to buy the meat which it produced and packaged from another LTV subsidiary, Wilson Foods. Wilson Foods used to be Wilson Sporting Goods. When I was a kid, I used to buy baseball gloves from Wilson. Now they are in the process of distributing meat.

LTV insisted that NEPCO buy its meat from this other of its subsidiaries at inflated prices, and so forth. This, again, comes from Daniels case studies.

A similar thing happened at Youngstown Sheet & Tube. Youngstown Sheet & Tube was required to pay more for raw materials—coal and iron ore—from its mines after the merger with Lykes than it had paid on the open market prior to that acquisition. The reason was that Youngstown Sheet & Tube began purchasing parts and equipment which had previously been supplied from local small businesses. Now it had to purchase them from a Lykes subsidiary at higher rates. The Daniels case study estimates that this arrangement cost Youngstown Sheet & Tube an additional $60 million a year.

In the case of the Sheller-Globe acquisition of Colonial Press, one of Sheller-Globe's primary objectives in the control of the press was to revolutionize the bookprinting industry by changing its orientation from sales to manufacturing. It wanted to concentrate on the efficient production of books rather than attracting clients. The decision to change the orientation of Colonial Press to manufacturing had a tremendous effect on the firm's customers, the publishing companies, including such giants as Readers Digest and Random House.

If you are in the business, you do not want to lose customers like those; they are very important.

Sheller-Globe believed that there was not a great deal of difference—and this is a quote from the management—between "Producing a steering wheel"—the business they were in—"and producing a book."

Publishers were no longer being given itemized cost receipts. As a result of all of this, in this particular case, "the publishing industry became alienated; sales declined; the management of the press under Sheller-Globe mistreated its customers"—this is a quote from a former manager——

Mr. **Bedell**. Excuse me, Mr. Harrison, but we have had that before in our testimony. We have had Sheller-Globe here.

Mr. **Harrison**. OK. Let me read my summary paragraph and then stop.

The conventional wisdom about highly centralized managerial corporations is that they have brought into the world a higher degree of efficiency in information and personnel management than has ever been before possible. What we have stumbled upon—and I emphasize "stumbled" because this was not the original objective of our research at all—is the mounting evidence, some of which I have presented to you, that the managers of the giant corporations and conglomerates frequently overmanage their subsidiaries, milk them of their profits, subject them to at best strenuous and sometimes impossible performance standards, interfere with local decisions about which the parents' managers are often poorly informed, and are quick to close the subsidiaries down when more profitable opportunities appear.

Mr. **Bedell**. Thank you, Mr. Harrison.

We have a fairly serious problem. We have to finish by 12 o'clock. We have four panels, and the Chair does not want to be difficult, but we have spent over one-half hour with our first witness.

I am told by staff that people were requested to hold this to 10 minutes if they could.

Your testimony will be entered in the record, and it is not a question of whether testimony is important; we know it is important; but we just simply do have a time problem, Mr. Bluestone. The Chair should have started earlier in impressing upon people the importance of the time.

If we take too much time for spoken testimony, then there will be no opportunity at all for members of the subcommittee to ask questions and have dialog.

So, I think we are going to have to start—and it is unfair to the other witnesses—limiting the time period to 10 minutes. I will notify you when the 10 minutes are up, and if you need another few minutes, we will allow it.

Mr. **Bluestone**. I will try to be very brief, Mr. Bedell.

Mr. **Bedell**. Thank you.

TESTIMONY OF BARRY BLUESTONE, ASSOCIATE PROFESSOR OF ECONOMICS, BOSTON COLLEGE, CHESTNUT HILL, MASS.

Mr. **Bluestone**. My colleague, Professor Harrison, has provided you with a lot of information about the impact of conglomerate mergers on plant closings. I am sure that your committee is also concerned about conglomerate mergers in terms of the concentration of political and economic power that this often entails.

What I would like to briefly talk about, however, is another impact that we sometimes overlook, an issue that Professor Root from Iowa will talk about also. This has to do with the impact on workers. Many of us in New England, of course, have seen huge numbers of closings which have resulted in massive unemployment in the past—1 million jobs between 1969 and 1976 as a result of plant closings.

What I would like to do is briefly talk about some of the mounting evidence about the direct costs and some of the indirect costs that are often overlooked in terms of the impact of conglomerate mergers and, more broadly, plant closings.

Whenever capital is moved, either from one part of the world to another or simply between assembly lines in the same factory, some people are likely to benefit while others pay a price. Who gains and who loses and by how much is, in fact, a very basic issue.

In any society, the degree of social and personal benefit relative to the social violence accompanying capital mobility is mostly determined by the structure of economic institutions and by the objectives of those who render control over productive assets. Indeed, in many of the closings that we have experienced in New England and other parts of the country, the closing was probably inevitable from the point of view of pure balance sheet comparison. But, as we have shown today, in many cases this was far from inevitable. In either case, whenever it occurs, its costs are great.

The extent of social violence wrought by capital mobility, often in the name of progress, is evident everywhere, but it is seldom measured or well documented. It tends to be submerged in gross national product figures and often disguised by impersonal unemployment rates.

What we are going to do here is simply mention some of the impacts of long-term unemployment, income loss, the destruction of personal individual wealth, and, indeed, the deterioration in physical and emotional well-being of those who lose their jobs.

We know now from a great number of individual case studies and increasingly from aggregate microdata that long-term unemployment is a major result of plant closings. Years ago, there were studies like those of the Packard closing and the Mack Truck plant closing, and in almost every one of these cases we found that unemployment for those who lost their jobs lasted from 10 months to 2 years or more.

However, in the most recent case—and one that we have mentioned already, the closing of Lykes Campbell works—Fortune magazine released a study in December of last year in which they appeared to be quite sanguine about what was happening 2 years after that closing. However, when you look at their statistics, one finds it hard to maintain an optimistic attitude. Over 60 percent of the workers who were laid off permanently when Lykes closed the

Campbell Works are still looking for jobs, were forced into early retirement, or were forced to move.

Indeed, I thought it was rather sardonic for Fortune to include in their story a picture showing a 32-year-old steelworker who, they said, "now had all the time he needed to practice piano."

I think if we were to extend that we would find that case after case after case show large amounts of long-term disemployment effects.

We know from a nationwide study done by Professors Parnes and King at Ohio State University that between one-eighth and one-fifth of all the men aged over 45 who have lost their job to a plant closing remained unemployed for at least 6 months and, in many cases, for over 2 years.

What we have found in our research is that, while a plant closing affects something less than a majority of the workers so adversely, the minority that it does affect are affected disastrously.

Let me go on and suggest that unemployment is not the only problem. We know from data analyzed by Louis Jacobson that the income loss associated with a plant closing can go on not only for 6 months or a year but for as many as 6 years or more.

In the automobile industry, if you were laid off today, 6 years from now you would be making, on average, 15 to 16 percent less than you would if you had kept your job. In the steel industry, 6 years from now you would be making only seven-eights of what you would if you had continued your job. In meat packing, you would only be making four-fifths as much 6 years from now.

But employment and income loss are not the only consequences. We know from the research of Dr. Harvey Brenner and others who have looked at physical and mental health that long-term unemployment has disastrous effects on people's emotional and physical condition. Brenner has done extensive studies, both in this country and in England, and shows that there are heightened levels of hypertension and suicide connected with long-term unemployment. We can talk about it in very calm and cool terms today, but when you realize that in the aftermath of a Federal Mogul Corp. plant closing in Detroit, 7 people of a workforce of 2,000 committed suicide, the issue is anything but academic.

All of Brenner's studies show that there are much higher levels of mortality, suicide, homicide, mental health admissions, and imprisonment rates due to plant closings. In fact, Brenner has calculated the following based on an increase in the overall unemployment rate of 1 percent: 37,000 total additional early deaths; 920 suicides; 650 homicides; 500 deaths from cirrhosis of the liver; 4,000 additional State mental health hospital admissions; and 3,300 additional State prison admissions.

Indeed, if we were to take the Federal Mogul Corp. example and extend it to the whole country, more people commit suicide because of permanent job loss than the United States lost in Vietnam.

The fact of the matter is that this is not a trivial problem. It is a major problem for individuals in every community in every part of our country. We must consider the impact of conglomerate merger not only in terms of the profit and loss statements of individual corporations, but we have to consider what the impact is on the profit and loss statements of individual families and their children.

This committee, of course, has to be as concerned about that problem as any other.

Thank you very much.

[Professors Bluestone and Harrison's research has been published as Capital and Communities: The Causes and Consequences of Private Disinvestment, by the Progressive Alliance, April 1980.]

Mr. **Bedell.** Thank you very much, Mr. Bluestone. That took you 9 minutes; we are very pleased.

Mr. Tauke?

Mr. **Tauke.** Following the chairman's suggestion, I am going to try to limit my questions. So, instead of asking a lot of questions from which I would ask you to reach conclusions, I am going to make a few statements about conclusions I have reached and ask for your reaction.

I think the members of this subcommittee are anxious to understand what the effects of conglomerate mergers are. I think we recognize that there are certain negative aspects that can come from conglomerate mergers, but I have to say, as I listen to your testimony, that there is a lot more than you apparently attribute to conglomerate mergers than I am willing to accept.

For example, you talk about the great regional differences in the country and suggest that at least part of the problem—is that there is more conglomerate merger activity in New England. I would suggest, on the other hand, that the reason we have some of these problems is because of the high labor costs in New England, the high energy costs in New England, and the high taxes in New England. That is why you have a higher level of plant closing there.

You talk about the women's apparel industry. For example, you say 3½ stores closed and only 1 opened. Is that not just an example of the kind of problems that we generally have in the women's apparel industry? Is it incorrect to assume that we, as a Nation, will have to eventually move away from some industries and into other industries because our cost of labor in this country is going to be greater than the costs in some other countries?

You also cited problems with conglomerate mergers in the shoe industry. May that not relate more to the exportation of hides and our practices and policies relating to that than to the policies relating to conglomerate mergers?

I guess what I am suggesting by all of this is that I am not certain that you have fully explained to us the causes or the policies that we have in the Federal Government that are permitting or encouraging conglomerate mergers. It would be my observation, generally, that there are many factors other than conglomerate mergers that cause the problems that you have suggested.

I am wondering, first of all, how much of this problem really results from conglomerate mergers and, second, what is it that we do in Government that causes or encourages conglomerate mergers.

Mr. **Bluestone.** Mr. Tauke, I would like to try to answer that question.

First of all, we have used New England examples because we have been able to obtain data set for New England and study that.

We both, however, having looked at other data would strongly suggest that, in fact, this is a problem not only in New England or particularly in New England but throughout the country.

Some of you may have seen table 7 on page 10(b) of our formal testimony. I would like to amplify one thing there that my colleague began to discuss. The point we were trying to make in table 7 is that conglomerate mergers are responsible for a disproportionate amount of closings relative to births compared to other types of corporate structures: Independent versus simple corporate. So, the major problem we see is not that New England is higher or lower than other areas of the country in terms of conglomerate mergers but that we think if this table were reproduced in other areas it would show that closings occur much more often, disproportionately often, when you have conglomerate forms of corporate control as opposed to independent or corporate.

In response to the second point——

Mr. TAUKE. May I just comment on that?

Mr. BLUESTONE. Certainly.

Mr. TAUKE. But that is not surprising to me because conglomerates, by their very nature, do not start up lots of businesses. Generally, they take on other businesses that are already in existence. So, is it surprising, as a result, that the number of startups would be somewhat less for conglomerates than for independents or corporates? Most businesses that start out, because of the nature of our economy, start out as small businesses. That is where the creativity is in the economy.

So, I am not surprised, or shocked, or really that impressed by the statistics that appear here.

Mr. BLUESTONE. So, what you are saying, if I understand you, is that they do not create any employment; the only thing that a conglomerate can do is destroy it?

Mr. TAUKE. First of all, this does not relate to employment; it relates to startups and closings, and we do not know if the startups were 10,000-employee plants and the closings were 1,000-employee plants, so it does not relate to employment.

Mr. BLUESTONE. We can give you employment numbers that parallel those.

Mr. TAUKE. Thank you.

Mr. BEDELL. Without objection, they will be included in the record at this point.

[Material referred to follows:]

Table 7

Start-Ups (or Reorganizations*) and Closings of Private Business Establishments in Ten Industries in New England, by Type of Ownership: 1969-1976

Industry and Form of Ownership[a] (S.I.C. codes in parentheses)	Start-Ups or Reorganizations[c]				Closings				Rates of Change		
	Establishments		Jobs		Establishments		Jobs		Ratios of closings to openings		Net % change in employment associated with start-ups and closings
	No.	pct. dist.	No.	pct. dist.	No.	pct dict.	No.	pct. dist.	Estabs.	Jobs	
Women's Apparel (233)											
Total	174	100%	8087	100%	326	100%	16123	100%	1.9	2.0	-10.1%
Independent	98	56	3418	42	217	67	8588	53	2.2	2.5	-10.5
Corporate	71	41	4228	52	92	28	6261	39	1.3	1.5	-7.8
Conglomerate	5	3	441	6	17	5	1274	8	3.4	2.9	-20.0
Paper Mills (262)											
Total	43	100	5016	100	43	100	6563	100	1.0	1.3	-2.1
Independent	17	40	380	8	17	39	480	7	1.0	1.3	-1.8
Corporate	24	56	4473	89	22	51	6004	91	0.9	1.3	-2.4
Conglomerate	2	4	163	3	4	10	79	2	2.0	0.5	+2.0
Commercial Printing (275)											
Total	688	100	7766	100	855	100	9187	100	1.2	1.2	-1.9
Independent	542	79	2752	35	758	89	4858	53	1.4	1.8	-4.2
Corporate	113	16	2575	33	65	7	2897	32	0.6	1.1	-2.3
Conglomerate	33	5	2439	32	32	4	1432	15	1.0	0.6	+9.9
Shoes (304)											
Total	84	100	9309	100	215	100	39029	100	2.6	4.2	-18.4
Independent	34	40	1568	17	105	49	12765	33	3.1	8.1	-24.7
Corporate	45	54	7103	76	80	37	20209	51	1.8	2.9	-13.4
Conglomerate	5	6	638	7	30	14	6054	16	6.0	9.5	-28.4
Metalwk'g Machinery (354)											
Total	306	100	9459	100	497	100	15377	100	1.6	1.6	-4.4
Independent	226	74	1410	15	403	81	3706	24	1.8	2.6	-4.4
Corporate	71	23	7433	78	74	15	8869	58	1.0	1.2	-2.3
Conglomerate	9	3	616	7	20	4	2802	18	2.2	4.6	-10.5
Computers (357)											
Total	111	100	17513	100	101	100	13949	100	0.9	0.8	+3.3
Independent	48	43	1318	8	57	56	1423	10	1.2	1.1	-0.5
Corporate	56	51	16109	91	36	36	12419	89	0.6	0.8	+3.9
Conglomerate	7	6	86	1	8	8	107	1	1.1	1.2	-1.4

(continued)

Table [illegible] (continuation)

Start-Ups (or Reorganizations*) and Closings of Private Business Establishments in Ten Industries in New England, by Type of Ownership: 1969-1976

Industry and Form of Ownership[a] (S.I.C. codes in parentheses)	Start-Ups or Reorganizations[c]				Closings				Rates of Change		
	Establishments		Jobs		Establishments		Jobs		Ratios of closings to openings		Net % change in employment associated with start-ups and closings
	No.	pct. dist.	No.	pct. dist.	No.	pct. dist.	No.	pct. dist.	Estabs.	Jobs	
Aircraft Engines (372)											
Total	30	100%	1705	100%	61	100	6119	100	2.0	3.6	-3.3
Independent	17	57	115	7	35	57	607	10	2.1	5.3	-4.6
Corporate	11	37	1562	91	17	28	3379	55	1.6	2.2	-1.6
Conglomerate	2	6	28	2	9	15	2133	35	4.5	76.2	-22.8
Department Stores (531)											
Total	417	100	29319	100	295	100	15525	100	0.7	0.5	+11.3
Independent	37	9	1265	4	42	14	1277	8	1.1	1.0	0.0
Corporate	344	82	27158	93	177	60	10690	69	0.5	0.4	+17.4
Conglomerate	36	9	896	3	76	26	3558	23	2.1	4.0	-27.0
Grocery Stores-Supermarkets (541)											
Total	2243	100	23969	100	5147	100	23461	100	2.3	1.0	+0.3
Independent	1692	75	9020	38	4776	93	14988	64	2.8	1.7	-6.4
Corporate	537	24	14782	61	329	6	6393	27	0.6	0.4	+18.4
Conglomerate	14	1	167	1	42	1	2080	9	3.0	12.5	-24.6
Hotels-Motels (701)											
Total	893	100	20994	100	1064	100	17663	100	1.2	0.8	+3.4
Independent	639	72	8239	39	927	87	12442	70	1.5	1.5	-5.8
Corporate	234	26	12306	59	104	10	3479	20	0.4	0.3	+4.6
Conglomerate	20	2	449	2	33	3	1742	10	1.7	3.9	-21.5

NOTES: Same as Table 4.

*The conglomerate start-ups in the table represent either literally new establishments or -- probably more commonly, although we have no information on this -- acquisitions which have been extensively reorganized, i.e., restructured sufficiently to prompt Dun and Bradstreet to assign a new DUNS number to them. Most acquired companies retain their individual identities and i.d. (DUNS) numbers; these are classified as "conglomerate" but not as "start-ups," and therefore do not appear in the table.

Mr. TAUKE. The second thing is that we do not know if conglomerates were generally taking up plants in businesses that are not very stable to begin with. As I go through this, I see lots of industries that do not appear particularly stable.

It would be my observation, I guess, that it is not particularly helpful for our economy to say that just because a business is in business that it ought to stay in business, because our economy has to have some turnover if we are going to be a viable and growing economy.

It is not all that surprising as a result that, if you have an industry that has a 5-percent return on it, the people would say, "My gosh; if I can take my dollar and invest it in the Treasury notes or money market certificates and get 12 percent, keeping it in an industry that has 5 percent does not seem to me to make too much sense." So that it is not all that surprising.

Mr. BLUESTONE. Perhaps I could very briefly reinterpret what you are saying. That is, conglomerates are not in the business of creating employment or starting up new shops. They are in the business of taking over existing ones, some of which we have shown are quite viable on anybody's books.

What we find is that what conglomerates can do—particularly because of tremendous advances in technology in the form of rapidly falling costs of transportation and communication—is take advantage of those technologies, if you will, but they do it by moving capital around at such a rapid rate that it creates tremendous social costs which, of course, the individual firm does not have to take into consideration.

In the pollution case, no individual firm would have to take its waste into consideration unless there were some regulation which said, "There are real costs being produced here. How are we going to internalize those externalities?" in the language of the economist.

The problem we find here is that there are tremendous externalities that the individual conglomerate never needs to take into consideration in their own profit-and-loss calculus. But, in fact, we have to because those are real social costs. That is the problem with conglomerate mergers.

Mr. HARRISON. I would like to say two things in response to something you have said.

This is not the appropriate time to get into a long discussion about the myth that New England is a high labor cost region. But, sir, it is a myth.

We have been doing research for the Economic Development Administration now for 2½ years, which we are not yet prepared to testify on today. But it is absolutely clear and central from that work that New England, as a result of a period of 30 years of tremendous stagnation and disproportionately high unemployment relative to other parts of the country, which has come to an end relatively recently, is now, by no stretch of the imagination, a high labor cost place. Indeed, one particularly dramatic study, which is just about to surface in the Boston business press and was done on contract to the High Technology Council of the State of Massachusetts, shows that the high technology, especially computer, companies in Massachusetts pay higher wages, occupation for occupation, to workers in Alabama, Texas, Mississippi, and California than they do to their skilled workers in Massachusetts.

What they are doing is taking advantage of a long period of depression in the region in which workers demands have declined, unionization has declined, and so forth. It is not a high cost-of-doing-business region any more.

Taxes are relatively higher, but the differentials in taxes now across States, thanks to the enormous number of tax breaks and tax incentives that have been built into the legislation of all of the New England States—something which some of us have done a great deal of writing on in other contexts—are reduced among States enormously.

Finally, you asked what the Federal Government can do about it—what does this have to do with the Federal Government? It would be totally inappropriate for us to allow the idea to continue that we are attributing all of the decline of what industry has declined to changes in ownership, conglomerate or any other kind. Clearly, there are a whole series of factors, and foreign competition is one of many important factors.

But there is another class of factors which this Federal Government, but not our State governments, has a great deal of responsibility for and has a great deal to say about. It has to do with a whole series of things in the tax code, starting with the way in which stock transfers are treated, as opposed to cash transfer. That is tax law; that can be changed. Or consider the treatment of the relocation of industry as a business expense to be written off. As a private citizen, I am delighted that if I move my family somewhere on business I can write off the moving costs as a business expense. To the extent large companies can do that—close down subsidiaries in one place, sell off the equipment, and write it off as a business tax expense, and set up in some other part of the country or overseas, that begins to be questionable.

George Peterson of the Urban Institute has made an analogous argument that the Federal Government, over the last 30 years, has actually subsidized the suburbanization of industry out of central cities by providing a tax writeoff for the development of new structures but not, until very recently, for the rehabilitation of older ones.

There are a whole series of elements in the tax, and, I might add, in the tariff codes which have had a great deal to do with making it very profitable to buy up viable businesses, drain them—I emphasize that those terms, "cash cow" and "cashbox," are not our invention; they come from the business community and the business press. Management schools teach students how to manage subsidiaries in order to reduce their own control of the cash flow.

Those factors are not the sole explanation for the decline of any area, and we certainly do not want to be on record as having suggested that. But they are very important factors and factors which most economists, unfortunately, tend not to talk about.

Mr. **Bedell.** Would the gentleman yield?

Mr. **Tauke.** I would be happy to.

Mr. **Bedell.** Would both of you furnish to the staff your recommendations as to legislative changes you think would help in terms of what we are trying to do for our society. Could you also note legislation which encourages conglomerate takeovers and conglomerate closure? It would be of help to us if you would do that.

Mr. Bluestone. Certainly.

[See part III of Harrison and Bluestone's, Capital and Communities.]

Mr. Bedell. Did you have any other questions?

Mr. Tauke. No; thank you.

Mr. Bedell. Mrs. Snowe?

Mrs. Snowe. I just have a few questions.

I appreciate your testimony here this morning.

I was just wondering how many case studies were involved in developing your research and your conclusions.

Mr. Bluestone. The particular work we have been doing for the Economic Development Administration——

Mrs. Snowe. Was it jointly done by both of you?

Mr. Harrison. Yes—and 20 other people.

Mr. Bluestone. We have been doing and are just completing now—it should be finished sometime early this summer—a general study of the whole New England economy. We have been doing it for a little over 2 years. As part of that, we have been looking at 12 industries in detail, including the paper and pulp industry in your neck of the woods.

We have developed—and this is not ready for release at this point—individual extensive case studies on 12 key industries in the region.

Mr. Harrison. That covers about 220 companies which were interviewed. And I would say that, on top of that—between the work of William Whyte, who has made his work available to us, and Beldon Daniels, who has just done a series of very detailed case studies on, I think, eight conglomerate acquisitions to see which have been responsible for undermining the solidity of the acquired firms—it probably means about 250 companies that have been directly interviewed by us and by the two related projects that we have been most closely in contact with.

Mrs. Snowe. In your study, in the conclusions you have arrived at, was there a general trend, or pattern, or consistency involved in the conglomerate mergers or takeovers? Have you been able to do something?

Mr. Bluestone. I was responsible for doing studies on both the aircraft industry—which is, by and large, in Connecticut and eastern Massachusetts—and the department store industry, two industries which you would think would be just about as far apart as you could possibly imagine.

We found, somewhat to my surprise, very similar conclusions about the impact of conglomerate merger—they call them "holding companies" in the department store industry—in terms of the setting of hurdle rates or profit targets in each one of the subsidiaries, and how they either expanded or closed down operations. This is particularly severe in the aircraft industry, where a number of firms have collapsed because of coproduction agreements, second sourcing, and parallel production.

We went into one department store after another, and divisions of large national holding companies were telling us, "Yes, indeed, we are making a profit in southern Maine," or, "We are making a profit in Connecticut. But, we have some sister companies that are making 2 percent more in Los Angeles, Phoenix, and Houston, and therefore we cannot get any capital to expand whatsoever here in New England, although we know we could be profitable by any standard market criterion besides that of the hurdle rate established by the parent company."

Mr. **Harrison**. I would like to add one finding about, again, northern New England. This comes from a case study of Maine, which is almost completed and will be published this spring. This is a doctoral dissertation in the economics department of MIT that I am supervising, and it is part of this large research project.

The single, most dramatic finding of it is absolutely extraordinary. We have been looking at the impact of the equivalent in the banking industry of what we are calling "conglomeration," that is, through correspondent banking arrangements, through the Bank Holding Company Act, what happens to small businesses trying to borrow money in particularly small towns in rural Maine. Twenty-five banks were interviewed in Maine. That is a lot of banks. There are not that many more banks in Maine.

The central finding of those interviews was that even the smallest neighborhood savings and loan, which traditionally was locked into the local community by a whole string of very informal arrangements like playing golf, going skiing, and hanging out at particular taverns—those relationships have been undermined by this fact. I think that, analytically, this is central to this; it is the most central finding that covers all of these industries. The smallest bank—through regulations that this Government has developed over a long period of time, is now integrated into an international capital market so that, where the local hardware store wanting a loan for inventory, for example, could offer a very minor, modest return and could not afford to pay more than a fairly low interest rate, and certainly not make very much profit for that bank—is now confronting the possibility of investing, instead, in the shared portfolio of, let us say, the First National Bank of Boston, the largest bank in the region, which can put its money into South African diamonds, which can put its money into Texas oil, and so forth.

This integration of the system means that even small lenders now have much greater opportunities for making even more money than they could before, and that acts to the detriment of small borrowers in the local community.

Mr. Tauke said——

Mr. **Bedell**. We are terribly short of time, Mr. Harrison. Could you cut it short?

Mr. **Bluestone**. Could I add this?

If I could just summarize in one sentence what this all means, after studying this for a couple of years, is that the smallest firm in the smallest community now must compete with nearly every other firm in the country and, indeed, the world.

Small hardware stores in Portland, Maine, are, in fact, competing with General Motors Corp.

Mr. **Snowe**. Thank you.

Mr. **Bedell**. We thank you for your testimony very, very much.

We are going to switch the schedule a little. Mr. Birch has consented to be third rather than second. Mr. Tauke wanted to be here during the testimony of the next two witnesses. We are going to ask Kenneth Root of Luther College of Decorah, Iowa, and Robers Stern of Cornell University to be our next two witnesses.

PANEL CONSISTING OF SOCIOLOGISTS: ROBERT STERN AND KENNETH ROOT

Mr. **Bedell**. Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Root**. I do.

Mr. **Stern**. I do.

Mr. **Bedell**. The Chair has a most difficult problem. We have a total of four panels with six witnesses left. We have had two, and we have taken over an hour on our first two witnesses. We have to adjourn by 12 o'clock, and it would be completely unfair—people have traveled long distances in order to testify—to close it off and not let some of the people testify.

So, I hate this very much, but we are going to have to absolutely limit everyone to 10 minutes in order to give other people an opportunity to be heard.

Your testimony will be entered in the record, and we would urge you to summarize just as much as you possibly could.

Who wants to go first?

TESTIMONY OF ROBERT STERN, NEW YORK STATE SCHOOL OF INDUSTRIAL AND LABOR RELATIONS, CORNELL UNIVERSITY, ITHACA, N.Y.

Mr. **Stern**. I will go first, Mr. Chairman. I am Bob Stern.

Mr. **Bedell**. OK, Mr. Stern.

Mr. **Stern**. I would like to shift the focus slightly from the discussion we just had concerning merger activity to look at communities and what the effects on these communities are of remote control, or what we commonly call absentee ownership.

The argument I would like to make is that, in the conglomerate merger activity that was described earlier, the effects of absentee ownership on community life are exaggerated. That is, they are more prevalent under these circumstances and occur more visibly.

Here I am summarizing the research of the last 35 years, which covers about 500 to 600 studies of the effects of absentee-owned firms on local community life and local community welfare.

I might add that the research comes from a combination of work that was done for a conference which the Federal Trade Commission sponsored on Firm Size, Market Structure, and Social Performance, and also from the New Systems of Work and Participation program, of which Professor Whyte is the principal investigator; Professor Harrison referred to him earlier.

Absentee-ownership, or absentee-controlled firms, produce a change in the way a corporation views the location in which its plants exist. That is, it no longer is concerned about the social life of a community in the same way that the owners of firms were when they were local people.

What this means is that a conflict in the form of economic calculation, or the way in which these corporations determine what is in their best interest, occurs. That calculation means that corporate welfare and community welfare are, in some sense, contradictory. They are not necessarily complementary.

There are many places in which you find that corporations make decisions without very much concern about the impact on the local community. The communities are simply viewed as locations, and as soon as the economic advantage of locating there disappears, the plant also disappears, or at least the corporation begins to consider moving the facility.

The problem has been around for a long time. It began when industry became nationally integrated, between, say, 1880 and 1930, but the first real research that was done was done for the Senate Select Small Business Committee in the 1940's. What that research showed was that there are differences between communities. In this particular study, there were matched samples of cities of different sizes: 100,000, 50,000, and 20,000. One city in each pair was dominated by firms controlled from the outside and the other by locally owned businesses.

The list of findings was fairly lengthy. C. Wright Mills and Melville Ulmer found that the absentee—controlled cities tended to have less employment stability, that is, they were more subject to big business cycle fluctuations; they had lower average wages per worker, although not in the manufacturing sector; there was a smaller number of businesses in these communities; there was less stability in the real estate market; greater decay of downtown areas existed, particularly as corporations moved out to the suburbs. There were lower retail sales and less variety of merchandising. In interviewing citizens in these communities, the researchers found there was much less satisfaction with the shopping facilities.

When they interviewed merchants, the merchants said, "Well, we really cannot afford to put more investment into our store—carry a wider variety of merchandise—because our town is dependent upon a particular industry or particular employer who is making decisions from a long distance." The result was a hesitance to reinvest or to invest more in the community.

In the 35 years that have passed, this finding was reconfirmed numerous times—the creation of a feeling of uncertainty results in a failure to reinvest in the community, to build up facilities.

At the time, the research identified greater levels of crowding, higher infant mortality rates—which is not a problem any more but did show that there were differences in health characteristics—lower levels of public expenditure on parks, health, and library facilities. Most important was the finding that there was a reduced number of what we think of as middle class small businessmen who participate in local government. That is, those people tended to withdraw from the local governments in their communities leaving politics to be dominated by larger corporations.

What this initial study did, interestingly enough, was identify three issues which have been the main research issues for the last 35 years and, I think, are the issues that you should consider as you think about legislation in this area.

The three issues which I would like to describe very briefly are, first, what I would call community vulnerability, or the loss of control over your own fate.

The second one is private welfare. That includes income, income distributions, land values, educational and occupational characteristics of the population.

Finally is public welfare—expenditures of the local municipal governments on police, fire, sanitation, health, et cetera.

Community vulnerability, I would argue, is the most important of these. First, it creates uncertainty about the local stock of jobs. That has already been discussed in the previous testimony and I do not really need to go over that again. However, Professor Harrison did allude to the case in Herkimer, N.Y., which is the one that I studied in great detail. It is very clear there that, if Sperry Rand had closed down that plant, the largest employer in town would have closed and, in interviewing people in the town, we know that a substantial loss in population would have occurred as well as a considerable amount of unemployment.

There are numerous other cases where this kind of effect can be found.

Professor Bluestone described for you the psychological, social, and economic consequences of plant closings. We are talking about the creation of uncertainty in these towns because they do not know what a large corporation is going to do in terms of making decisions about plant closings.

The point that is most important, however, is that there have been four statewide studies done. Two of them, done in Wisconsin and Nebraska, showed that when within-State corporations merge with corporations owned outside of the State, there tends to be a decrease in the growth rate of jobs and income in the areas where these mergers occur within these merged corporations.

There is also a pair of studies done in Maine and Iowa that show that locally controlled firms increase employment at a faster rate than do outside-controlled corporations. The argument here is not that locally controlled firms are more efficient. The argument is that these larger firms have more capital mobility; they are in the worldwide capital market that was described to you earlier, and therefore they can pick up and go somewhere else to get a higher return.[1]

The point, of course, is that the community then suffers. I am not making comments here about corporate policy, itself.

A second effect is that the community leadership tends to lose its power base. There are several studies that show that locals withdraw from the political arena while managers of absentee corporations come to set agendas in the community and define community issues. These managers, however, are usually poorly integrated into the social structure of the community; they are not part of the longstanding community social life; they do not participate in it; they tend to segregate themselves to a certain degree.

If these managers of absentee corporations then come to lead the community, in terms of agenda setting, they are the ones with the skills to deal with economic development, and know how to deal with Government regulations. If a plant closes down and these managers are moved somewhere else, the skills of the community are moved; there is an inability to deal with crises which occur.

---

[1] Committee Note: See Appendix M for study regarding Wisconsin. See Appendix P for study regarding Iowa.

In the Herkimer case, there were local skills available to put a package together to try to purchase the plant, and what that did was create a stronger base of local skills so that the community could continue to try to develop and meet future crises.

The research tends to show that in the other two areas, private welfare and public welfare, results are mixed. Clearly, absentee-owned corporations do increase the level of income in the community; they do tend to spread the income out over the population somewhat more evenly.

However, there are certain groups in the population who do not receive many of these benefits, particularly those of lower skill, and there is no reduction in rural poverty as a result of having a plant move into an area where it did not exist before.

The findings also tend to show that where tax incentives or some kind of subsidy are given to a corporation, there is little or no gain in the public sector in terms of total expenditures per capita. There is often a decline in expenditures per capita in health and educational areas because of increased demand by the people who move in through the corporation. In general, the research tends to show, in these 400 or 500 articles, that community vulnerability is increased: There is loss of control over one's own fate. Private welfare increases, but private welfare increases at the cost of public welfare. This decline usually means a decline in the level of services provided by the municipality.

Thank you.

[A more detailed statement by Professor Stern can be found in Appendix Q.]

[Professor Stern's prepared statement follows:]

Prepared Statement of Robert N. Stern, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y.

ABSENTEE FIRM CONTROL AND LOCAL COMMUNITY WELFARE

I have been asked to comment on existing knowledge of the effects of absentee firm control on the welfare of communities in which such firms are located. The review reported here is based on research undertaken in conjunction with a conference sponsored by the Federal Trade Commission on "Firm Size, Market Structure and Social Performance" as well as data collected as part of the New Systems of Work and Participation Program at Cornell University. That research outlined in another statement given to this committee suggests that conglomerate style merger activity exaggerates many of the effects of absentee ownership which I will describe here.

The problem of absentee firm control only became relevant in the American economy with the national integration of American industry which took place between 1880 and 1930. The consolidation which occurred transformed the ownership structure of corporate assets in our economy. Local owners of businesses who had spent their lives in a specific community building their companies while participating in community life sold out to firms located in distant cities or expanded by opening branch plants in other locations and becoming absentee owners themselves.

Absentee control changed the corporation's view of the surrounding community. Communities were viewed as locations for plants which were appropriate only so long as the location provided economic advantages. When such a location was no longer economically rational, the plant was closed and facilities built elsewhere.

This economic calculation creates a fundamental conflict between the calculus of corporate welfare and local community welfare. Local municipalities are viewed as potential obstacles to the free flow of capital and use of productive resources. Thus, companies with little or no stake in the maintenance of community life will see local governments as entities which may provide facilitating actions for the company or set up constraints which are perceived as nuisances for the business.

The first solid research on the welfare effects of absentee owned corporations (AOCs) was done by C. Wright Mills and Melville Ulmer for the Senate Small Business Committee in 1946. They matched cities on industrial development and region, then compared the characteristics of cities with a high proportion of employment in absentee owned firms with those where outside control was low. Their impressive list of differences shows that cities with greater absentee control had:

(a) greater employment fluctuations (instability);

(b) lower average wages per worker outside the manufacturing sector;

(c) a smaller number of businesses;

(d) less stability in real estate prices;

(e) greater decay of downtown areas (as companies moved to the suburbs);

(f) lower retail sales with less variety of merchandise in the stores (merchants claimed they could not risk investing in their stores because of the high degree of uncertainty created by the absentee employers);

(g) greater levels of crowding;

(h) higher infant mortality;

(i) lower public expenditures percapita on parks, health and libraries; and

(j) a reduced number of middle class small businessmen (who usually provided civic leadership). The AOC's managers and professionals tended to withdraw from community political and social life.

This early study identifies three critical issues which I would like to discuss and illustrate. These are the major issues which absentee ownership affects and which merit attention in examining the influence of corporate behavior on community welfare.

(a) Community Vulnerability (loss of control over one's own fate);

(b) Private Welfare (income, income distribution, land values, educational and occupational characteristics); and

(c) Public Welfare (expenditures on police, fire, sanitation, education, and health).

Community vulnerability is perhaps the most critical but invisible type of impact on AOCs. First, they create uncertainty regarding the stock of local jobs. This effect is visible in the attention given to plant closings which devastate smaller communities. In Herkimer, New York where we have done considerable research, the threatened closure of the Library Bureau, a subsidiary of Sperry Rand, would have eliminated the largest employer in the three community area. Fortunately, local community residents, employees and entrepreneurs saw that the plant could be run profitably and purchased it from Sperry. In Hudson, New York, the workers at the Universal Atlas Cement Company, a subsidiary of U.S. Steel were not so lucky. In both cases, reliance on single large outside employers created uncertainty about the economic future. The uncertainty reduces the willingness to invest.

Further, the pyschological, social and economic uncertainty created by job loss (or even the rumors of a closing) are well documented. The important point here is that research in Wisconsin and Nebraska has shown that mergers of local firms with conglomerates controlled outside the state decreased rates of growth in employment and payroll in the acquired firms. In addition, outside financial, legal and accounting services produced reduced revenue for community institutions and professionals. Studies in Maine and Iowa show that locally controlled firms increase employment more than locally based subsidiaries of absentee corporations.

A second community level effect is the decline in the power base of local elites and the increasing power of locally based managers of absentee corporations whose commitment to the community is tenuous. Several studies show that locals withdraw from the political arena while managers of AOCs come to set agendas and define community issues. However, these managers are usually poorly integrated into the local social system. The result is both increased corporate influence and the reduction of the local skilled leadership base. Should the corporation close its facility in a small city or town, the capacity to respond to economic crises is unavailable.

I would argue that Herkimer represents a case in which the effort to save the Library Bureau produced increased skills for meeting for economic crises and improved capabilities for further economic development. An organized community can deal with economic crises more easily.

A third effect is the loss of local institutions to deal with local needs. When decisions are made at a distant location, local circumstances may not be the main criteria involved in solving problems. This effect is quite clear in industrial relations where grievances are settled by lawyers from corporate headquarters rather than local managers and collective bargaining is run from the home office.

Finally, AOCs are associated with decentralized local government in which interest group competition is the dominant mode of decision making. Decentralized governments are most effective in allocating divisible goods such as jobs, welfare and zoning but are less effective than centralized forms in producing indivisible goods such as desegregation plans, floridation or urban renewal.

All these changes in government take place in a most peculiar fashion. Although AOC managers clearly influence local government, they do so in relative obscurity. A five year study of the effects of Jones and Laughlin's plant location in Hennepin County, IL shows that J&L clearly influenced local decisions but residents seldom identified the managers as local elites or influencials.

The private welfare of residents in towns with AOCs has been the focus of studies of rural industrialization. They show that the decline in rural population is halted by the location of a firm in a county. However, the population decline is halted by in-migration of managers and skilled workers attracted to the company. The outflow of the agricultural population does not change. On the positive side, per capita income goes up along with average educational levels and occupational prestige. Unemployment levels decline and opportunity generally improves. Total local private income streams improve even when locational tax subsidies are given.

At the same time, the benefits are not distributed equally. Rural poverty is not reduced and employment of lesser skilled workers does not increase. As land values increase farmers find their taxes going up as a result of location near commercial property but their income remains tied to farming. Further the employment multipliers are actually quite low (1.0–1.68) indicating that the new plant creates few new jobs outside the plant itself. Small business is hurt by the creation of regional shopping areas.

Evidence concerning public expenditures suggests that AOCs are associated with increases in local revenues, but also create demands which often outweigh revenue gains. Studies in metropolitan areas show that the higher the proportion employment in AOCs the lower are per capita expenditures on public services. In rural areas, substantial increases in the fiscal resource base of the community are often less than increased demands and costs of services to new industry and increased population. Research results are mixed as to the overall balance but they are clear that public welfare measured by per capita expenditures will not increase when locational subsidies are given. If subsidies do work in bringing new industry, private welfare gains are being obtained at the expense of public expenditure and service levels. One study in Oklahoma shows that the average yearly gain in the private sector of twelve communities with new plants was $152,000 but the gain in school district revenue averaged $401 and governmental revenue $521. In six of the twelve communities the municipal revenue change was actually negative.

Absentee owned corporations seem to bring increased wealth to the citizens of communities in which they locate, but the wealth is fragile. It rests upon increased vulnerability of the community to decisions made by those with little commitment to the protection of local community life. Some corporations have gone so far as to help their executives locate housing in nearby communities to hold down taxes and land values. Community welfare in the hands of such an economic calculus creates enormous uncertainty about the future. Control over one's life is diminished substantially.

Mr. **Bedell**. Thank you very much, Mr. Stern.

Mr. Root, we are glad to have you here from Iowa. I think Mr. Tauke also wants to issue a word of welcome.

Mr. **Tauke**. Thank you, Mr. Chairman.

I do appreciate the effort that Dr. Root and all the witnesses have made to come to Washington to share their views with us.

I will not list your credentials, but I do want to tell the members of the panel that Dr. Root has a national reputation in this area. He gave me a booklet this morning which I hope to share with the other members of the panel.

TESTIMONY OF KENNETH A. ROOT, SOCIOLOGIST, LUTHER COLLEGE, DECORAH, IOWA

Mr. **Root**. Mr. Chairman and members of the subcommittee, this particular panel of Professor Stern and I varies from those preceding and I think those following in that we are sociologists and the other witnesses today tend to be economists, so our orientations are going to be very different. Also, I think for the people on the subcommittee it is important for you to know that Professor Stern and I are involved in unrelated projects, and our testimonies differ in that Professor Stern is giving an overview; I am going to focus in on one particular plant closure.

I want to take a look, very briefly, on the impact on the workers and their families. I want to emphasize those impacts to closures which might occur. I want to stress that particular phrase, when pruning of less productive units takes place in a recent merger. Just because there is a merger does not necessarily mean that there is going to be closure; but if there is a closure, these are the kinds of impacts that could occur.

I am going to talk about a particular plant shutdown in Mason City, Iowa. It is a meatpacking operation, so it is something that those of you from Iowa know a good deal about. [See Appendix R.]

This was a family-owned operation; it was called "Decker's"; and was started in the early 1900's, acquired by Armour & Co. in 1935, and then acquired by Greyhound when Greyhound took over Armour in 1970. On August 14, 1975, Armour & Co. announced that it was going to close the Mason City facility. The local press made a big to-do about this; this was the largest industry in town, both in terms of numbers of employees and in terms of payroll, with a $17 million annual payroll for a community of 35,000.

On the day of closure, several people were interviewed by the local press. One was a man who made this comment: "We don't owe this company anything. In my opinion, they have treated us like dogs in the last few years here."

Were the man who had made this particular comment, a worker who had worked there for 13 years, the only person to assess mistreatment on the part of management or owners, then we could quickly overlook the comment. But, in fact, interviewing a 10-percent systematic sample of these workers at four different times over 2½ years, we found that many of the workers attributed bad times or difficulty or poor working conditions to Greyhound.

I would not say that the Greyhound acquisition determined the shutdown, but it might have exacerbated the closure, and I want to be very up-front with you and say that there are a lot of changes that have taken place in meatpacking and a number of other areas in our society, and, Mr. Tauke has indicated here, there are other reasons for closures, and conglomerate mergers may be one of those. There are some specific kinds of findings that I think we need to take a look at: One. Earlier testimony indicated that there was lengthy unemployment. I have not found that to be true in this particular case, and I think more recent studies in the 1970's would indicate that length of unemployment is not necessarily as long as it has been in earlier periods of time—studies that were done in the 1950's and 1960's.

Two. But even though there have been relatively short periods of unemployment—let's say 2 months—workers will still say, "It is really bad; it is tough on me," or, "It's tough on my family," or, "It's a bad impact from the closure."

And workers with relatively long periods of unemployment will say the same thing. I find that, regardless of the length of unemployment, then, that alone does not necessarily dictate the psychological and social repercussions of closure.

So, one of the losses is the feelings of people, and many people would attribute negative kinds of impacts, regardless of and independent of the length of time they are without work.

Three. Family patterns of help exchanges deteriorate quickly. Some people get dissatisfied with the people they have helped in their extended kin when the extended kin no longer helped them when they were down and out. I have cited in the written testimony some examples of this.

Four. Many of the workers, if they were given an option to change their mind after the closure, would have taken a different kind of option in response to the closure. They might have taken separation pay, or they may have done something different than they decided at the closure.

Five. Financial losses were extremely heavy for families, and many of the workers sent their spouses to work on a full-time or part-time basis—a large number started after the closure in an attempt to compensate and maintain the same scale of living.

We have to keep in mind that some of those spouses went to work without the full support of the male workers. And, as a result of that, this created some family disharmony. As a matter of fact, most of the people we interviewed were married family people, and we asked them prior to the plant closure to describe their family situation—marital satisfaction. Most said, "very happy"; 2½ years later, most people said, "unhappy," or "very unhappy."

So, we are talking about major kinds of shifts, largely, and I am attributing them to plant closures. Most of the people in the closure indicated that they were shocked, hurt, depressed, or sick when they heard the announcement of the closure and, indeed, the rumors had been flying rampant for a long period of time.

In the written testimony I have tried to describe a category of people that I would call "casualties," people who are really hurting and reeling financially, people who have gone through a divorce, people who have lost their homes, people who have taken separation pay—a good chunk of it—and walked through it within 6 months and have nothing to show for it. These are people who are psychologically and socially hurting extensively, even 2½ years after the closure.

So, let me conclude very briefly with some suggestions, I guess, in the written testimony too. If your subcommittee can support the position that mergers increment closures, it is probably not so much what the Federal Government is doing to facilitate that but what the Federal Government policy is not doing to assist the communities and the workers confronted with those particular closures. I believe there are real losses of human capital.

I think we need some legislation to provide sufficient leadtime between the announcement to close and the actual closure. I think, in addition to that, it would be important to have a mechanism which provides a range of options for displaced workers including transfer, termination, or whatever it might be.

We sorely lack adequate professional resources and counseling personnel in the community.

Last, I think there are all kinds of alternatives that should be considered: Worker ownership is but one; it could be inducements for owners to build a new facility in the same community.

Perhaps we need to introduce some disincentives for closure, or we need to think of building an umbrella that would provide some kind of corrective Federal action and assistance to displaced workers, independent of the closure causes that would put all the people under TRA, the Department of Defense military closures, or whatever they might be.

Thank you.

[Professor Root's prepared statement follows:]

PREPARED STATEMENT OF KENNETH A. ROOT, SOCIOLOGIST, LUTHER COLLEGE, DECORAH, IOWA*

Mr. Chairman and members of the subcommittee, as a sociologist I've become interested in the impacts to workers and their families when "their" plant closes. I suppose one of the reasons for this interest is that I'm a son of a three-time displaced worker; the first time losing a bookkeeper position when "his" company fell victim to depression hard-times, then confronting job loss as a machinist when military production was curtailed after W.W. II, and for the last time as a displaced shipping clerk for a surgical equipment company when several product lines were discontinued during the Eisenhower recession of the late 1950's. Within a year of the last time he was made redundant, my father died from a series of heart attacks. I do know something of worker and family response to job displacement through personal experience, but today I want to emphasize some of those impacts from closures which might occur (I want to stress that phrase) when pruning of less productive units take place in a recent merger.

Let me use an example from the meatpacking industry and a sample of employees I've interviewed over the past five years as an illustration.[1]

Jacob Decker & Sons was a Mason City, Iowa, meatpacking operation, with it's local facility built in 1900. In 1935 Deckers was purchased by Armour & Co., although the Decker name continued to be used in the area. 1970 reflected another change in the Mason City operation and elsewhere when Greyhound purchased Armour & Co. Five years after acquiring the Armour operation, Greyhound announced that the Mason City facility would close and provided the six months notice to workers on February 14, 1975. August 15 the old facility closed its doors. The Mason City Globe Gazette covered the closure thoroughly, including the last workday for employees. On that date, in an article written by Tom Still and appearing in the August 16 Gazette, Still quoted several workers leaving, for the last time, their Armour job. Many indicated they would transfer. One was Cliff Peterson, an Armour employee for 13 years and a Mason City native who thought "Time ran out on us." In his view, either Mason City or St. Paul would close, and "it was a matter of economics" to close the Mason City plant first. According to the article, Peterson would transfer, leaving friends and neighbors behind, but he made a strong statement about the company: "We don't owe this company nothing. In my opinion, they've treated us like dogs in the last few years here."

Were Cliff the only one to voice such a view, to assess mistreatment on the part of management/owners we would quickly overlook the comment. In fact, several workers cited a change in the working conditions and attributed the closure directly to Greyhound owners, implying that such would not have been the case under Decker operation or under Armour and Co. leadership. Although it may be true that Greyhound ownership exacerbated the closure, I would be sorely remiss if I didn't remind you of the tremendous changes in the meatpacking industry over the past 25 years; a period that saw major packing cities lose all their large, big-name operations, with thousands of workers displaced. And with the advent of refrigerated boxcars and trucks and the creation of new, modernized and specialized facilities in small communities offering easy access to the livestock market, multistoried factories employing up to 3000 workers were no longer needed. That's part of the picture, whether there were mergers or not; a picture reflecting technological change and a varied perspective on industrial efficiency. Cliff Peterson recognized that side of the coin when he spoke of the "matter of economics" and whether St. Paul or Mason City would close first. The other side, however, is also real; and that's the views of the workers and the impacts on their lives from the shutdown. From a 10 percent systematic[a] random draw of the Mason City bargaining unit employees, and a sample of 103, we note several significant points:

---

* Kenneth A. Root is a sociologist, teaching at Luther College, Decorah, Iowa, and an active researcher on plant shutdowns. He holds a Ph. D. from the University of Iowa.

[1] Funds for the earlier stages of data collection and initial analysis in the Mason City Study were provided by The State of Iowa, Office for Planning and Programming, Contracts 19-5-050-1002-11 and 19-5-050-1002-25. Support for the fourth interview and analysis was provided by the North Central Regional Center for Rural Development, with additional funding by The State of Iowa, Department of Social Services. The North Central Regional Center for Rural Development has provided continuing support to the project. Although these agencies have assisted in the development of the research, none of these agencies are responsible for the interpretation of data, nor for any personal views I have expressed here; that responsibility is mine alone.

1. The length of time a worker was unemployed was not related to whether they perceived the shutdown as "generally good" for their families, or generally bad. Equally as many of those workers with a short duration of unemployment (less than one month) perceived the closing as generally bad as good and slightly more of the long-term unemployed (one year of more) indicated that the plant closing was good than bad.

2. Family patterns of help-exchange were modified for significant numbers with most changes reflecting an exchange decline. Some displaced workers were bitter over this, best described in the words of a worker: "So like I say, I don't hold grudges, but it's something I just don't want to think about. I went down to see them whenever anything needed to be fixed or anything needed to be done. I was always there. Even if I had something else to do, I never said no. When the chips were down like they were for us, we needed help, there was no one. I'm sure one day they will realize what they did to us when we needed them the worst."

3. If workers were free to make a new choice about their selected option made at the closure, 38 percent would elect to do so. (From data collected at the fourth interview, just two years after the closure.) Although much of this shift comes from workers who separated from the company and on second thought would have taken the layoff option, we also find people in each category who responded that the closure was generally "bad" for their families. This is interesting because even though they might be working full-time for Armour and building more seniority, there were negative impacts. These respondents are likely reflecting on the non-financial impacts of a plant closing, including temporary adjustments or the forced termination of close ties with kin and friends in Mason City.

4. Financial losses were, in part, handled through sending additional family members into the labor market. Twenty (20) percent (n=20) of the workers in the sample had a spouse already working full-time prior to the announcement. Another two (2) percent were working part-time but shifted to full-time after the closure announcement was made. An additional 20 (n=20) percent of the sample had spouse in the work force after the closure, although not all right away, and not all with their blessing. The male dissatisfaction with outside-the-home work posed stress on some family relationships.

5. Some workers had difficulty finding new jobs—or satisfying jobs at the same rate of pay, although most Mason City Armour workers were able to reenter the job market quickly. The displacement literature indicates that age, or extensive competition with others who are in a similar bind and compete with one another for a limited number of jobs, minimizes job market chances. (Root, 1979a) Bale (1979) states: The situation is sometimes exacerbated by the fact that the firm from which workers are displaced is the sole major employer in a small community. Opportunities for reemployment in that community are, therefore, minimal.

6. Although rumors had persisted for at least five years that the Mason City Armour facility would close, 85 percent of the sample said they were shocked, hurt, depressed, or sick when they heard the announcement.

As a sociologist interested in the social impacts of shutdowns, it's clear that not all shutdowns result from a merger. But it is also clear that there are potential rewards to corporations who acquire other companies which have segments or units that are deemed low on the profit side the ledger. These units may be closed for tax benefits alone, and low profitability does not necessarily mean unprofitable, just less than desired. In my view—stemming from my research—there are winners and losers in a closure. The winners tend to be the owners of the corporation; the losers are generally the workers.

Let me review briefly the history of those "losers." Among the first studies of job loss were Depression era research projects that described the people involved in such shutdowns as job losers, suffering status change and loss of dignity, if not

---

[a] Appendix A provides a methodological background to the study, while Appendix B provides a table comparing the closure options selected for both the sample and the total Armour work force.

within the larger society, certainly within their families.[3] Expectant repercussions of harsh economic loss, status decline, or loss of meaningful involvement were also described in the shutdowns of the 1950's and 1960's. Although some of these studies, such as Too Old to Work—Too Young to Retire emphasized the situation and plight of those over 45, other studies, including Unwanted Workers, provide a descriptive title for all those caught in the vise of displacement.[4] The displacement research completed during the 1970's reflected a twist in the theme; a finding that there was a positive response to anticipated or actual job loss among a segment of respondents.[5] Data from the Mason City study indicates that many workers did feel that they and their families gained from their termination, while a sizable number were also relatively undisturbed by the closing, maintaining that job loss from Armour was neither good nor bad. But there were job losers, those workers who maintained that the shutdown was not good for them and their families, primarily from an economic standpoint; and another contingent I identify as casualties. Casualties are those workers who identify the closing as "bad" and perceive their loss as continuing. They are not people who only believe the plant closing was a financial loss, or who only miss the benefits, but these are the terminated workers who are still upset over the closing and lost extensively in the shutdown. Some lost their homes and savings, or spent all their separation pay; others lost their spouse and family and are still reeling from those personal losses. The casualties are heavy losers, and their social-psychological well-being is still imbalanced, requiring them to make adjustments—even two years after the closure.

One of the workers I've identified as a casualty is a man I'll call Carl, a 37-year-old divorced man with three teenage children who reside with him. Carl had worked at the Mason City Armour plant for more than 17 years, and took separation pay at the time of closure. Within six months Carl had spent his entire separation pay and "had nothing to show for it." With no income and his separation pay spent he was forced to move in with other relatives. An interviewer asked Carl questions during the fourth interview, a little over two years after the shutdown and while he was only sporadically employed:

Question. All in all do you think you have adjusted well, moderately well or not too good to the plant closing?

Answer. Not at all.

Question. So would you say that the closing was generally good or generally bad?

Answer. Terrible.

Question. Basically because you haven't been able to find a job?

Answer. Well, not just that. I had a chance to go to another packing house in another town, but I didn't want to move. I just think closing the packing house is disastrous. Maybe not for some people, but for me it was. At the time I thought, man, this is great, but I don't anymore. I'm eating my words, see.

Although fewer in number than we would have expected, research from several studies in the 1970's indicates that there continues to be both job losers and casualties. (Root, 1979.)

A supportive illustration of the anxiety surrounding a shutdown comes from an earlier Armour closure where a sample of Wilson employees in a neighboring plant were also interviewed. At this point, Wilson & Co. was a recent acquisition of LTV, but Greyhound had not purchased Armour. Armour workers in Omaha, Nebraska, received word September 29, 1967, their plant would close on March 29, 1968, effecting the total workforce of 2500. Meanwhile there was speculation that both Swift & Wilson might also close and an Omaha *World-Herald* newspaper reporter inquired at both Swift and Wilson. Swift would not comment, while Wilson indicated that they would not close, since they had recently spent 1.5 million on modification. Data from a comparison of Wilson and Armour workers indicated that the Wilson workers, supposedly reassured that their plant was going to stay alive, were even more alienated and pessimistic than were those about to lose their jobs at the Armour facility. Even with the company announcement, Wilson workers continued to be even more apprehensive than their Armour counterparts at the second interview which took place 9 months after the shutdown. The disbelief of management support in the wake of merger and the fear of closure, may be more agonizing than confronting the know-closure and straight-away. To the best of my knowledge, this post-merger fear and rumor still has yet to be studied.

Let me conclude with some brief suggestions, premised on the stance that if you can support the position that mergers increment closures, you might well consider:

---

[3] See Angell, 1936; Komarovsky, 1940 Bakke, 1940; and Eisenberg and Lazarsfeld, 1938.

[4] See Sheppard *et al.*; and Wilcock and Franke.

[5] See Little, Strange and Root (1978).

(1) the real losses of human capital, and generate legislation to provide sufficient lead time between the announcement-to-close and the actual closure;

(2) a mechanism which provides a range of options for displaced workers; including transfer, termination at a point which is beneficial to the soon-to-be displaced worker, extending UI benefits *and* adequate professional resource and counseling personnel;

(3) and maybe alternatives—like worker ownership; inducement for owners to build a new facility in the same community while the old one is being phased out; the introduction of a disincentive for a closure; or, corrective federal action and assistance to displaced workers, independent of the closure cause.

REFERENCES

Angell, Robert Cooley (1936) The Family Encounters the Depression. New York: Charles Scribner's Sons.

Bale, Malcom D. (1979) "Adjustment Assistance: Dealing with Import-Displaced Workers." pp. 149-163 in W. Adams, R. C. Amacher, et al., Tariffs, Quotas, and Trade: The Politics of Protectionism. San Francisco: Institute for Contemporary Studies.

Bakke, E. Wight (1940) Citizens Without Work. New Haven, Connecticut: Yale University Press.

Eisenberg, Philip and Paul F. Lazarsfeld (1938) "The Psychological Effects of Unemployment." Psychological Bulletin 35 (June): 358-391.

Komarovsky, Mirra (1940) The Unemployed Man and His Family. New York: Dryden Press.

Little, Craig (1977) "Technical-Professional Unemployment: Middle-Class Adaptability to Personal Crisis." *The Sociological Quarterly,* (Spring): 262-274.

Root, Kenneth A. (1978) "Job Loss and Job Losers," a paper presented at the Annual Meetings of the Society for the Study of Social Problems, San Francisco, September 1-4.

Root, Kenneth A. (1979a) Companies, Mines and Factories—Shutdowns, Closures and Moves. Monticello, Illinois: Vance Bibliographies.

Root, Kenneth A. (1979b) Perspectives for Communities and Organizations on Plant Closings and Job Dislocations. Ames, Iowa: Iowa State University, North Central Regional Center for Rural Development.

Sheppard, Harold L., Louis A. Ferman and Seymour Faber (1960) Too Old to Work—Too Young to Retire: A Case Study of a Permanent Plant Shutdown. Washington, D.C.: Government Printing Office.

Strange, Walter G. (1977) "A Psycholosocial Study of Job Loss: Worker Reaction to a Plant Closing in a Company Town in Southern Appalachia." Ph.D. Dissertation, Cornell University.

Wilcock, Richard C. and Walter H. Franke (1963) Unwanted Workers. Glencoe, Illinois: Free Press.

[APPENDIX A]

The Mason City Study

The intial study plan was to draw a weighted, stratified sample of family units from the 1300 bargaining unit employees at Armour, but a major difficulty was encountered when neither the Company would provide a roster of their married employees nor would the local Union provide a checkoff list of Union members. Since demographic characteristics were therefore not available we were forced to use a seniority roster which had been provided to the Mayor's Task Force Committee by the Company. From this roster we drew a 10 percent systematic random sample which yielded a sample of 103 respondents.

To assess worker and family problems due to plant shutdown, we collected data from the worker and spouse during four time periods. The first interview was completed in July and August of 1975, just prior to the plant closing. Included in that interview schedule were: recall questions about how family members felt and behaved when they first learned that Armour was closing down, demographic characteristics, as well as indicators of marital satisfaction, mental health, and work satisfaction.

During the first interview, data were collected via use of pairs of male-female interviewers, and it was typical in our initial study to have the female interviewer conduct the interview with the male respondent and vice-versa. The worker interview (N=89 M, 7F) was a structured interview, while the spouse interview (N=5 M, 57 F) was a focused interview which was tape recorded.

We had anticipated that most workers would stay on with the Armour Company until the closing had actually taken place since the union-management contract provided that bargaining unit employees who wish to receive separation pay, retirement benefits, or exercise transfer rights, must remain with the company until the actual plant closing. Such a contract encouraged workers to remain within Mason City until the time of the actual closing, and this was the case among workers in our sample. In only two instances did workers drawn in the sample actually leave Armour prior to the plant closing.

Data from the displaced workers were collected again during the latter part of March, 1976, eight months after the closing. The March data collection was a personal interview with those workers in the sample who were still in the Mason City area. There were 77 of the original 103 in the sample and 71 of the 77 were interviewed. At this interview, we asked workers about their present work or nonwork situation, their financial condition, and numerous attitudinal items measuring anomia, sex-role orientation, and husband-wife power relationships.

Shortly after the March data were collected, Armour announced it would build a new meat processing plant in Mason City. Although some of the plant operations would change and not all of the same jobs would be available, this facility would employ 350 workers and was expected to be ready for operation in late 1977.

In August, 1976, and one year after the plant had shut down, we again collected data from families in the sample. Only this time we again interviewed spouses (and only the spouses) of the displaced workers. An extensive interview was developed which solicited information on the work or job-seeking behavior of herself, her husband and other family members, parental relationships with children, and the spouse's perceptions of role behaviors and adjustments of family members. In this August interview, the number of displaced workers who were married or whose marriages were still intact was reduced to only 48. Of those 48 families, we were able to interview the spouse in 41.[1]

A fourth and final interview with all workers was completed from mid-September until the end of October, 1977, just over two years from the closing. For married workers, spouses were involved in the personal interview at the same time, with a single interviewer. Portions of these interviews were taped. Although the majority of the respondents remained in the North Iowa area, thereby facilitating personal interviews, cost factors limited personal access to transferred workers in Texas, Oregon, and Washington. These workers, and other difficult-to-complete respondents were contacted via telephone and serial interviews completed with workers and spouse. Transfers to Armour facilities located in Minnesota and Nebraska and elsewhere in Iowa were personally interviewed.

During this fourth interview, data collection emphasis focused on adjustment to the shutdown, including: (a) identifying networks of assistance of relatives, friends, and clergy; (b) assessing solidarity of family members; and (c) asking what special problems or benefits the family has had as a result of the closing.

Of the original sample of 103 (one worker and spouse had died), 86 or 81 percent were located and interviewed at this fourth stage. In four instances, spouses did not participate in the interview by generally, family participation was cooperative, and open. None of the respondents received compensation at any time.

[APPENDIX B]

FREQUENCY AND PERCENT OF OPTIONS SELECTED BY SAMPLE, AND TOTAL ARMOUR WORK FORCE

	Sample		Total work force	
	Number	Percent	Number	Percent
Severance	29	28	322	30
Retirement	13	13	139	13
Transfer	9	9	145	14
Temporary transfer	17	16	197	18
Lay-off	32	31	227	21
No rights	3	3	44	4
Total	103	100	1,074	100

---

[1] At the first interview we completed 95 of the 103 drawn. Seventy-four (74) of these workers were married, 7 separated or divorced, 2 widowed, and 12 single. At the second interview 77 of the 95 were still in Mason City or the surrounding area, and we completed interviews with 71. At the third interview we wanted to interview the spouse and were confined again to interview in the Mason City area. At this third interview, we completed 41 of the 48 possible interviews. The decline in sample from the second to third interviews is accounted for by the spouse interview, eliminating single, divorced/separated, and widows (there were 5 additional divorces/separations as well as one additional widow during this time), and also because transfers were now completed for those Mason City workers who had rights to work in another plant in the Armour chain.

Mr. **Bedell**. Thank you very much, Mr. Root. You did keep your word and stay under the 10-minute limit.

Mr. Tauke?

Mr. **Tauke**. Thank you very much.

I think it is much easier to make the case against, if you will, corporate mergers or for some sort of new look at corporate mergers from a sociologist's standpoint than from an economist's standpoint because I do not think yet we have seen a case where a corporation or conglomerate made a bad decision economically, from their standpoint. It may be a bad decision as far as the community is concerned, and I think that is what you are driving at.

Could either of you give us any observations that you might have about what conglomerate or corporate mergers mean to a community—a small rural community, especially as we are accustomed to in most areas of the country and certainly in Iowa? What does this do for a small community, first of all if the plant continues to operate, and, second, if the plant closes?

Mr. **Stern**. If you are talking about a corporation that was locally owned and then is merged into another corporation, the first effect is the creation of a great deal of uncertainty which causes people to manifest some of the psychological symptoms that were discussed earlier, some of the stress symptoms. But, in the long run, what it tends to do is cause people to be hesitant to invest their own capital or resources in the community; that is the first thing.

The second thing is that it tends to cause the replacement of the people who are the local community leadership by those who are in the management of the corporation. It happens in a very curious way. In Illinois, there is a long-term study being done of a Jones & Laughlin plant that was opened there. It shows that even though Jones & Laughlin executives have a considerable amount of influence in local community politics—setting agendas, setting educational policy—when you ask the population who is running the show, they do not identify those executives; that is, they are not identified as local leaders. So, it happens without most of the population being very conscious of it.

What this means is that decisions in the community are made for the benefit or with the interests of this new corporation in mind to a greater degree than they would have been before when the local leaders were members of the local social structure.

Mr. **Root**. Three things come quickly to mind: One. Is the rumor mill that comes up—perhaps the rumor that the plant was going to be closed. Those rumors are damaging and harmful to morale.

Two. Different management personnel arrive. Those management people have different kinds of skills and probably less paternalism to the employees. As a result of that, there is always a base of comparison from the workers standpoint—comparison of treatment when they are with Decker as opposed to Armour & Armour as opposed to Greyhound, for example.

Three. The other thing I think comes in is this. Once a merger takes place, you are in a much larger network. The management is not tied to the local community, as Professor Stern has indicated. And, in addition to that, workers can transfer in—can bump in—when a plant closure somewhere else occurs. So, you are increasing the fluidity of the community, which may be a healthy kind of condition but it ought to bring to mind to the people in the local community that the particular facility they are in could also close and they, too, may be needing to vacate at some particular time. That is a major confrontation for many of the people who grew up in that particular community and have been long-term residents of that community when they find themselves locked into an employer that now provides them an opportunity to transfer, and they are possibly going to a community some extended miles from their family, relatives, and friends.

Mr. STERN. Could I make a quick addition to that? The transferring, or bumping, issue is important in a unionized context particularly. It may be that there are not always transfer rights available.

One of the things that is appearing in a study that is being done in northern Michigan is that the ability of local unions and local management to handle plant grievances begins to disappear when you have the merger occur. If there is a grievance that goes to a fourth step, the corporate lawyer comes in from headquarters and the international lawyer comes in, and they have the grievance hearing. Then language gets incorporated into the next contract. The local collective bargaining agreement no longer functions on a day-to-day basis to control labor relations.

Thus, one of the impacts in the unionized context is to make local unions less responsive and local managements less responsive to the workers in the community.

Mr. TAUKE. The disaffection that you refer to—does it take place whether or not a plant closes, and would it be the same before a plant closed as afterwards? Or do you think this may be something that you discovered after the plant closed and resulted from the bitterness associated with that closing?

Mr. ROOT. No; I think it exists whether or not there is a closure. I think it is the relative comparison that provides a better or worse treatment. Generally, I think it is because of less paternalism, because of greater distance, because of involvement sometimes of third parties. There is less affection, and so it becomes a dissatisfying kind of experience to some people, but they are locked into their jobs and will continue to work there; they are just not as satisfied or happy with it.

Mr. TAUKE. Recognizing the time limits, I will refrain from any more questions, but I do commend you for your testimony.

Mr. BEDELL. Thank you, Mr. Tauke.

Mr. Hanley?

Mr. HANLEY. Thank you, Mr. Chairman.

I am really not equipped to ask questions. I regret very much my inability to have stayed and heard the witnesses out. I will be reading all of their testimony in recognition of my keen interest in the subject matter.

Doctor, you have studied, I understand, the problem in specifically upstate New York?

Mr. **STERN**. We have been involved in two separate pieces of research. One of them has focused on a number of communities in upstate New York, particularly in Herkimer, N.Y., with the Library Bureau, and also with the Saratoga Knitting Mill in Saratoga.

Mr. **HANLEY**. Did you do anything on the Rockwell takeover of Porter Cable in Syracuse, N.Y., and the subsequent phaseout of it?

Mr. **STERN**. No; we have not worked on that, ourselves, but Professor Edelstein at Syracuse University has worked on that, and he would be the person to talk to on that problem.

Mr. **HANLEY**. Is anyone doing anything on the UTC takeover of Carrier Corp.

Mr. **STERN**. Not in our research group.

We have focused on situations in which communities face plant closings and then have had to find some way to deal with that. We have worked on how they develop feasibility studies; how they could raise money to see whether or not the plant could actually become community or worker owned. In the Herkimer case, for example, the people in the town bought the plant through conventional stock ownership.

Mr. **HANLEY**. Thank you very much.

Thank you, Mr. Chairman.

Mr. **BEDELL**. Mrs. Snowe?

Mrs. **SNOWE**. I have just one quick observation or question.

I appreciate both of your testimonies, and I think they illustrate very well the social impact and implications as a result of loss of employment to an individual.

You were describing the situations, and I can certainly relate to some of the communities at home in Maine which are very well dependent on particularly one major industry in a given community.

What struck me as interesting is this: As you know, many of the State and local governments do somersaults to attract major industries to their locales so that they can expand the employment base and revenue base. They issue industrial revenue bonds or tax credits, as I know our legislature has given to a major corporation to locate in Maine.

In those instances, should they be examined more carefully? I have never thought of it from that perspective. Certainly, it is attractive to create a locally based employment in a given area because it integrates much better with the community, as you have said, than absentee ownership and management. But it does not always work out that way, obviously. The ideal situation would be to have that, but in States like Maine it is very difficult to attract industry to locate there, and tax credits have enabled us to do that in several instances recently. I know we have used industrial revenue bonds.

Mr. **Stern**. The research, particularly in an area called rural industrialization, which is a whole area of agricultural economics and rural sociology, shows that when a subsidy is given you are trading off increases in private income for municipal revenue. That is, the demand on municipalities for services exceeds the increased revenue which they get when subsidies are given.

However, the private income in the community goes up substantially. So there is some tradeoff being made.

I would argue that the subsidies have a negative impact. What has been created is competition between States to try to lure industry to each State, so people are falling over one another to try to give bigger tax breaks.

Mr. **Root**. It is a good question. I think you should ask it also of the economists. But I will try to give you a sociological perspective.

I think it is important for a community to have diversification for a variety of reasons. But it has been my observation that local industrial recruiters will do cartwheels to attract new industry, sometimes robbing from another community or State and not paying much attention to the industry that is already there.

I think they could at least provide some incentive to those industries that are already there to stay and be happy so that if, indeed, they need to modernize they are going to modernize locally and remain within the community rather than go to the sunbelt, or wherever else it might be, or be robbed by another industrial recruiter.

Mrs. **Snowe**. I know it has created hostility in some areas with the businesses that are already located in that area. They are saying, "Why are they helping out an industry that has not been located in this area." They are planning to stay, and their families are there, and they have been there for generations or whatever.

OK. Thank you.

Mr. **Bedell**. Thank you. We appreciate very much your testimony. We appreciate particularly the fact that you have helped us with our time problem.

Our next witness is David Birch.

Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Birch**. I do.

Mr. **Bedell**. We want to thank you, Mr. Birch. We particularly want to thank you for agreeing to be No. 3 instead of No. 2.

I understand your testimony is very short, but we will certainly appreciate anything you can do to shorten the time because we have a real problem in seeing that the other three witnesses, who have traveled great distances, have an opportunity to testify.

TESTIMONY OF DAVID L. BIRCH, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MASS.

Mr. **Birch**. As a panel of one, I will do my best, Mr. Chairman.

For some time now, a group of us at MIT have been interested in the process by which jobs are created. As we have dug into it, we have put together a file of 5.6 million business establishments over time; this sample covers about 80 percent of private sector employment.

We developed a fairly inexpensive analytical system that permits us to examine how each business contributed to job growth during the 1969–76 period.

I will speak briefly about what we have found since I last testified before your subcommittee and then turn to the particular effects of acquisition on acquired firms.

We found that there are great disparities in the rate at which employment grows across the country which should certainly come as no surprise; the South and West are growing much faster than the Northeast and Midwest, and the rural areas are growing faster than the cities.

We find that very few of these differences in employment growth are due to migration of firms in the strict sense, which is not unrelated to your previous question. Virtually no one hires a moving van and moves their business from one region to another.

And very little of it is due to differences in the rate at which jobs are lost each year due to the death or contraction of establishments. This rate is about a constant 8 percent per year in most places. If you can think of jobs as being like water in a bathtub, the rate at which water leaks out of the tub is about the same for all areas, and it is leaking at a pretty high rate. Each area loses about 50 percent of its job base every 5 years.

Differences between water levels and the tubs must depend almost entirely on how fast the faucets filling the tubs are running. That is the rate at which new replacement jobs are being generated.

From a policy point of view, I think it is important to understand who is making these decisions to replace lost jobs, which is related to the question you were asking, Mrs. Snowe. First, it tends to be smaller companies. About two-thirds of all net new jobs generated between 1969 and 1976 were generated by firms with 20 or fewer employees.

Establishments generating jobs tend to be young; about 80 percent of replacement jobs are generated by establishments that are 4 years old or younger. [See Appendix S.]

They tend to be volatile. Volatile firms, on average, are much more likely to generate jobs while stable firms are more likely to die. Worse still from a prediction point of view, firms that have declined lately but survived are more likely to grow, and firms that have grown recently are more likely to decline in the future.

Job-generating firms are far more likely to be in the service and trade sectors than in manufacturing. Between 1969 and 1976, in our sample, 6.7 million jobs were generated. Of those, agriculture generated 105,000; manufacturing actually lost 151,000 on balance; other industries, including transportation and construction, gained 1.9 million; trade, wholesale and retail, gained 2.6 million; services gained 2.3 million.

In view of the importance of smaller firms to job creation, we recently turned our attention to the question: What happens to a smaller firm when it is acquired by a larger one? Does the small firm slow down once it becomes part of a larger corporation, or does it grow faster once it gains access to more capital or management talent?

As part of that general inquiry, we asked a broader question: What effect does ownership, in general, have on growth? Do subsidiaries and branches of larger companies tend to provide more or fewer jobs than their independent counterparts?

Answering this second question first, we find that, while independents, particularly small ones, tend to dominate the job-creation process, it is more because of their numbers than their growth rate. In fact, subsidiaries and branches are growing two or three times faster, in general, than independents of the same size.

This says very little, however, about what happens to an individual firm that is acquired. It could simply be that conglomerates are picking winners but doing little else for them.

To get at the question of what happens during acquisition, we identified about 6,400 independent firms that were acquired and looked at what happened to them before and after acquisition. For comparison purposes, we followed another 1.3 million independents that were not acquired during the same period.

The results are fairly clear. Conglomerates tend to acquire the faster growing independents but the acquisition does little to speed up the acquired firms' growth. In fact, during the 1972–74 post-acquisition period we studied, the independents improved their growth rate faster than the acquired firms did. So, it does not appear that acquisition has much of a positive effect—at least a positive short-term effect—on job creation.

Our brief initial inquiry into this area has raised a lot more questions than it has answered. We would like to know if there are any sharp regional variations in this phenomenon. Initial evidence suggests, for example, that very large and very small firms in New England benefited substantially more from acquisition than the national average would suggest. We have not had time to analyze the other regions to compare against.

We wanted to know if there were variations due to the industry and to the age of the firm acquired: Do young firms benefit more or less from acquisition than older ones? We wanted to see what effect acquisition had on the death rate of acquired firms. We would also like to know if acquired firms are better shielded from recession than their independent counterparts. We would like to follow them for a longer period of time to see what happens over, say, a 10- or 12-year period rather than just a 2- or 3-year period.

I will try to stay in touch with the subcommittee as we explore these questions in the weeks ahead, and I will try to make the answers available to you as best I can.

Thank you.

[Professor Birch's prepared statement follows:]

Prepared Statement of David L. Birch, MIT, Cambridge, Mass.

MIT PROGRAM ON NEIGHBORHOOD AND REGIONAL CHANGE

For some time now, a group of us at MIT have been interested in the process by which jobs are created. In order to explore this subject in detail, we have assembled abbreviated case histories on about 5.6 million U.S. business establishments. For each establishment, we can trace changes in its employment, industry, sales, location, corporate affiliation (if any), and age over a seven-year period from 1969 to 1976. The sample covers about 80 percent of all U.S. establishments recorded by the Census Bureau in its County Business Patterns series.

We have developed in parallel a relatively inexpensive analytical system that permits us to pose and answer a number of questions about the structure and performance of various components of the U.S. economy by building the economy up from its pieces. We can add up the histories of each establishment in a city or state or region to see which groups of establishments are contributing the most.

As we compared places, it became obvious that some places are growing more rapidly than others—which should come as no surprise. More interesting, though, was the fact that very few of the differences from place to place are due to firms moving from one place to another in the sense of hiring a moving van and relocating.

Few of the regional differences are due to differences in the rate at which jobs are lost each year—either by firms closing or contracting. Furthermore, this loss of jobs is quite high—a remarkable 8 percent per year. In other words, we turn over about half of our job base every five years. This loss rate does vary slightly with the business cycle in the expected direction, rising about one percent in bad times and falling about one percent in good times. At any instant, however, it is quite similar from place to place. Job losses thus appear to be much more a function of management skills than location.

Most of the regional differences in growth, then, are due to differences in the rate at which lost jobs are replaced—either by new firms starting up or by existing firms expanding and/or opening up new branches or subsidiaries. From a policy standpoint, it is important to understand who generates these replacement jobs, and what role corporate acquisition plays in that process.

First, it tends to be smaller establishments that create jobs. About two-thirds of all net new jobs created between 1969 and 1976 were created by establishments with twenty or fewer employees.

Job-creating establishments tend to be young. About 80 percent of the replacement jobs are created by establishments 4 years old or younger.

Job creators tend to be volatile. Volatile firms are much more likely, on average, to generate jobs, while stable firms are more likely to die. Firms that have declined lately, but have survived, are more likely to grow, and firms that have expanded rapidly in recent years are more likely to contract.

Most of our new jobs are now found in the trade and services sectors rather than in manufacturing. Of the 6.7 million net new jobs generated by establishments in our sample between 1969 and 1976, for instance, virtually none were generated by manufacturers:

Sector:	*Net jobs created*
Agriculture	105,000
Manufacturing	−151,000
Other Industry (including transportation and construction)	1,900,000
Trade	2,600,000
Services (business and personal)	2,300,000
Total	6,754,000

It is not unreasonable to conclude from these findings that: (1) small firms play a vital role in creating jobs, and (2) small firms are particularly difficult to reach directly with government programs because they are so numerous and their behavior is so difficult to predict. It is important, therefore, to understand the natural evolutionary path that smaller companies seem to follow to make certain that, at a minimum, government actions do not obstruct those pathways and thereby thwart the substantial job creating powers of our small businesses.

One important step in the life of a small, independent business is the moment it is acquired by a larger one. In recent years, the conventional securities markets have provided fewer opportunities for a small business to "go public" and realize the fruits of its labors.[1] An alternate method of capitalizing a small enterprise is to sell it to a larger conglomerate, placing the burden of capital raising on the larger company for whom capital is easier to get.

The increasing habit of selling a company to another company rather than to the public raises a number of questions about the structure of American industry. Most of these questions relate to the intent of the antitrust statutes, and are beyond the scope of our research. We have, however, just recently begun asking one question that may be relevant: What happens to the job-creating powers of smaller, independent businesses when they are acquired? Do they lose their entrepreneurial drive as part of a larger entity, and slow down, or do they take advantage of the increased access to capital to grow? On the way to answering that question, we also asked a broader one: what is the relative contribution of independents, subsidiaries, and branches to job creation?

---

[1] Common stock initial public offerings, for example, fell from about 1,300 in 1969 to 25 in the depths of the 1975 recession, and were back up to only 58 in 1978.

Our first step in addressing this broader question was to determine if any particular form of enterprise generates more jobs than another. We used the 1969-1974 period (avoiding the distortions caused by the 1974-1976 recession), and controlled for size to obtain Table 1. Our finding about the importance of the 0-20 group as a source of new jobs holds as well for the 1969-1974 period. We note also the importance of branches in this process.

TABLE 1.—PERCENT DISTRIBUTION OF NET EMPLOYMENT CHANGE BY SIZE AND LEGAL STATUS OF U.S. ESTABLISHMENTS, 1969-74

[In percent]

Status	Employment size					
	0 to 20	21 to 50	51 to 100	101 to 500	Over 500	Total
Independent	44.9	2.1	−2.0	−4.6	−0.4	40.0
Subsidiary	1.7	.9	.4	−.5	−2.4	0
Branch	14.3	10.0	8.4	15.8	8.8	57.3
Headquarters	5.4	1.0	−.1	−1.7	−2.0	2.7
Total	66.3	14.0	6.7	8.9	4.0	100.0

Note.—Total net employment change in our sample during this interval was 5,827,108 jobs.

Small independent firms dominate job creation primarily because of their number, not their rate of growth. If we examine the average annual growth rate of establishments for this same set of categories (see Table 2) we find that subsidiaries and branches are growing substantially faster than independents are. They are simply starting from a much smaller base. Again, there is a distinct fall-off with increasing size for all forms of ownership.

The fact that establishments affiliated with larger corporations grow (and provide net new employment) at a faster rate than their independent counterparts says little about the experience of the individual establishment that is acquired. We were able in our sample to identify 6,046 such establishments who were independent in 1969, were acquired during the 1969-72 period, and continued in their affiliated status during 1972-74. We compared them with a sample of 1,301,894 independent establishments who remained alive and independent during the entire five-year period. By breaking the period into parts, we can see what happened to acquire firms after they were acquired, and compare that to a similar set of independents that were not acquired. Table 3 summarizes some of our preliminary results.

CUMULATIVE PORTION OF ESTABLISHMENTS AND JOBS BELONGING TO DIFFERENT SIZE GROUPINGS

[In percent]

Number of employees	Establishments	Jobs
0 to 20	88.3	26.4
0 to 100	97.8	49.7
0 to 500	99.7	72.6

The distribution of our sample is very close to the distribution of the establishment population as a whole.

TABLE 2.—AVERAGE ANNUAL PERCENT GROWTH IN NET EMPLOYMENT FOR U.S. ESTABLISHMENTS BY SIZE AND LEGAL STATUS, 1969–74

[In percent]

Status	Employment size				
	0 to 20	21 to 50	51 to 100	101 to 500	500+
Independent	6.6	0.7	−1.1	−2.3	−0.4
Subsidiary	12.2	4.5	1.5	−.7	−2.8
Branch	24.5	17.8	13.0	6.6	1.8
Headquarters	12.7	2.7	−.2	−1.8	−1.2

TABLE 3.—AVERAGE ANNUAL PERCENT GROWTH OF U.S. ESTABLISHMENTS BY SIZE AND LEGAL STATUS, 1969–72 AND 1972–74

[In percent]

Size in 1969	Growth during		Change in growth rate
	1969–72	1972–74	
Independents throughout:			
0 to 20	8.5	3.5	−5.0
21 to 50	.5	2.1	+1.6
51 to 100	−1.0	1.4	+2.4
101 to 500	−1.8	1.1	+2.9
Over 500	2.1	1.4	−.7
Establishments acquired during 1969–72:			
0 to 20	14.2	3.4	−10.8
21 to 50	2.1	3.6	+1.5
51 to 100	.5	2.2	+1.7
101 to 500	−.8	1.7	+2.5
Over 500	−8.3	−2.6	+5.7

The short-term effect of acquisition on the acquired independent firm appears to be a mixed blessing at best. The smallest firms are clearly picked for their rapid growth, but that growth slows down to the average of the independent group as a whole after acquisition.

Acquired middle-sized firms (those with 21-500 employees) all grow more rapidly than their independent counterparts, but they were growing more rapidly before acquisition as well—that is why they were chosen. After taking account of this head start, the independent middle-sized firms actually improved their growth rates more than the acquired ones did during the expansionary 1972–74 period.

On the large end of the scale, corporate buyers apparently went after declining firms and arrested that decline somewhat through the infusion of capital and management skill, although not enough to turn them around on average. The large independents throughout the period were growing at all times, although their growth slowed down somewhat during 1972–74.

On balance, the acquisition process appears to have had little effect on most acquired companies other than to identify them as growing faster than most and to help them keep somewhat ahead of their independent counterparts. It has certainly done little to increase their growth performance relative to the independent from whom they have been culled. The one exception appears to be at the high end of the scale, and our sample size in this domain is too small (28 acquired firms) to come to any strong conclusions.

We have been examining these questions surrounding acquisition for only a short time, and find that our initial inquiry has raised at least as many questions as it has answered. We would like to know if there are any sharp regional variations. Preliminary analyses show, for example, that acquisition helped smaller and larger acquired firms a great deal more in an older area like New England than it did for the nation as a whole. But we have not yet examined the other regions to see how they fared. Nor have we looked at obvious variations due to the industry and age of the acquired firms.

We would like to see what effect acquisition has upon the death rate of establishments. Our analyses thus far merely examine those firms that remain active during

the five-year period under study. We would like to know, for instance, if acquisition protects an establishment against failure, or increases the chance of failure (through liquidation), and how this phenomenon varies by region. We would also like to span a longer period after acquisition to see if the long-term affects are different from the results of the first two years. In particular, we would like to know if acquired firms were shielded from, or were more vulnerable to, the 1974–76 recession. We will try in stay to touch with the Subcommittee as we explore this expanded set of questions and will make findings available as best we can.

SAMPLE OF INDEPENDENT AND ACQUIRED FIRMS (BY SIZE OF FIRM)

Size	Independent	Acquired
0 to 20	1,211,302	3,962
21 to 50	66,336	1,143
51 to 100	16,833	530
101 to 500	6,963	383
Over 500	460	28
Total	1,301,894	6,046

Mr. BEDELL. Thank you very much, Mr. Birch.

Mr. Hanley?

Mr. HANLEY. I have no questions, thank you, Mr. Chairman.

Mr. BEDELL. Mrs. Snowe?

Mrs. SNOWE. Thank you, Mr. Chairman. I just have one question.

There were 4,500 acquisitions in 1969 and 2,100 in 1978. Can you characterize any differences between the mergers or the acquisitions that were occurring in the 1960's as opposed to today? Were they different in size, style, or significance?

Mr. BIRCH. We have not been looking at this for a long enough period of time to separate that all out. The only ones we have looked at carefully are the acquisitions that took place in the early 1970's, and I really do not have any basis for comparison to offer you. I hope to, perhaps, in a few months.

Mrs. SNOWE. Secondly, why do you think that growth is stifled; or why do you think that, after the acquisitions occur, the independently growing business is all of a sudden stifled from growing any further?

Mr. BIRCH. They do not stifle. They were growing faster before they were acquired, and they continue to grow faster after they are acquired. It is just that when the 1972–74 period came along they capitalized less in terms of increasing their growth than the independents did. They are all still growing. In fact, the acquired firms still grow faster; they just do not accelerate their growth as much as the independents do in an expansionary period. In fact, in many cases they slow down substantially—particularly small businesses that were acquired; the small businesses were growing at a very high rate before they were acquired; they grow at a much slower and more average rate after acquisition.

Mrs. SNOWE. I see.

Mr. BIRCH. But they are still positive; they have not gone down, they have just slowed down.

Mrs. SNOWE. In most cases?

Mr. BIRCH. On the average—I am talking about a sample of about 6,400 that we have looked at.

Mrs. SNOWE. Thank you.

Mr. BEDELL. Thank you, Mrs. Snowe.

Following that questioning, we had testimony last week that indicated that 80 percent of manufacturing assets are now owned by some 500 corporations. Have you looked at that area to see how much growth there is in manufacturing?

Mr. **Birch**. In the initial look, I have not broken it out by industry and looked at it carefully enough to be able to tell for sure. But I do know, from what I have found so far, that the subsidiaries and branches of conglomerates are growing faster than, on average, the independents. In other words, they are more rapidly growing, in some cases by a factor of two, or three, or four.

Mr. **Bedell**. You have not made a study of those 500?

Mr. **Birch**. No, I have not made a study. We have, in fact, identified all the branches and subsidiaries of all those large corporations. I just have not done an analysis of them.

Mr. **Bedell**. Have you done any work to indicate how efficiency compares in smaller and larger firms?

Mr. **Birch**. That is a very, very difficult topic. The answer to your question is, I have not, but I think it is a very difficult question to answer; it is so difficult to measure efficiency. It gets into questions of productivity.

I know the Science Foundation, for example, has found that small, independent companies tend to have a much higher rate of product innovation than larger ones do, and patent applications, and that sort of thing. But that is not really a measure of efficiency; it is a measure of innovation.

Productivity per person, I think it is a very difficult thing to measure.

Mr. **Bedell**. So, you have not really done anything in terms of the economies of scale?

Mr. **Birch**. Well, economies of scale are interesting. I have not done anything. I recently read of a thing done by an economist named Mike Sherer which suggests that, for a very high percentage of goods-producing industries—mainly manufacturing industries—the plants operating at about a third of the optimal scale are practically as efficient as plants operating at the optimal scale. In other words, the curve is very flat.

Mr. **Bedell**. And what is the optimal scale?

Mr. **Birch**. Let us say the optimal scale is 1,000 employees for a particular industry, be it the steel industry or something else. Plants operating with 300 employees are virtually as competitive and efficient as plants operating at 1,000, for a very large percentage of them. The economies of scale tend to be much less than perhaps you might assume by knowing what the optimum is.

Mr. **Bedell**. We thank you very much for your testimony, Mr. Birch. We particularly appreciate your help with our time problem.

PANEL CONSISTING OF ECONOMISTS: YALE BROZEN, ROBERT HESSEN, AND GEORGE BENSTON

Mr. **Bedell**. Our last panel consists of three witnesses: George Benston from the University of Rochester, Rochester, N.Y.; Yale Brozen, the University of Chicago, Chicago; and Robert Hessen, Hoover Institute on War, Revolution, and Peace, Stanford University, Calif.

Would those three panelists please come forward?

Do you swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Benston**. I do.

Mr. **Brozen**. I do.

Mr. **Hessen**. I do.

Mr. **Bedell**. We realize you have come long distances and are here to testify, and I am at least pleased that we have been able to move along so that you will have a chance.

Would Mr. Benston like to go first?

Mr. **Benston**. I have only spoken to Yale Brozen and suggested that he go first.

Mr. **Bedell**. Mr. Brozen, do you wish to go first?

Mr. **Brozen**. Certainly.

TESTIMONY OF YALE BROZEN, UNIVERSITY OF CHICAGO, CHICAGO, ILL.

Mr. **Brozen**. I will very briefly offer some evidence on the efficiency issue.

First of all, let me point out that for a study done on all New York Stock Exchange firms that were acquired in the postwar period, the evidence indicates that, on the average, they have been less well managed than the average New York Stock Exchange firm. In the 4-year period preceding their acquisition, their stockholders had lost 14 percent relative to the average New York Stock Exchange listed firm.

The specific evidence I want to turn to on whether or not conglomerates improve efficiency is this. There is evidence from the enterprise statistics from the census of manufacturing surveys that have been done, and they do indicate that the conglomerates do improve our efficiency; they improve our productivity, a badly needed activity in view of the limping productivity record of the past decade.

That conglomerates are more efficient than single industry firms was first demonstrated by Prof. Victor Fuchs in his examination of the company statistics from the 1954 census of manufacturers. With those data, he found that value added per employee in conglomerates exceeded that in single establishment companies by 28 percent and exceeded that in multiunit single industry firms by 11 percent. In only 6 of the 76 industries examined did conglomerates use employees less productively than single unit companies. Also, conglomerates paid their employees 9 percent more than single unit firms and 4 percent more than the multiunit single industry firms.

I have updated Professor Fuch's analysis with data from the 1963 and 1972 census of manufacturers, and those are some of the data that are in the table that has been distributed to you.

An analysis of 107 industries from the 1963 census of manufacturers' enterprise statistics shows even greater productivity and pay rates in the conglomerates relative to the single unit and multiunit single industry companies than in 1954.

Value added per employee in the conglomerates rose from 28 percent more than single unit firms in 1954 to 38 percent more in 1963. Conglomerate value added per employee rose from 11 percent to 15 percent more than the multiunit single industry firms. Also, pay rates in conglomerates rose from 9 percent more than single unit firms in 1954 to 13 percent more.

That 1963 situation is what we economists would call a "market in disequilibrium." The productivity and pay of workers in conglomerates exceeded what they could produce and earn elsewhere by a greater than normal amount. Such disequilibria give rise to unusually high activity then in moving resources from their less productive to their more productive uses and moving them from less productive to more productive management. That disequilibrium was probably one of the more important reasons for the conglomerate merger wave of the 1960's.

Whatever the reason, the increase in conglomeration in the 1960's did move resources and did bring the economy back toward a structural equilibrium between 1963 and 1972. Value added per employee fell from a level 30 percent greater in conglomerates in 1963 than in single industry firms to a level 17 percent greater in 1972, as a result of that reallocation of resources from single industry to multi-industry firms.

That suggests that it was the less efficient, single industry firms that conglomerates acquired. It was in these that conglomerates could bring about the improvements in output per employee typical of conglomerates relative to the typical single industry firm. In this, the conglomerate merger movement of the 1960's may have been similar to the horizontal merger movement of the 1930's and 1940's in which most of the acquired companies were of suboptimal capacity.

What the sources of the greater productivity of employees of conglomerates are has not been determined. But we can speculate on it. Perhaps conglomerates are quicker to take action to improve performance when performance in a division lags; perhaps conglomerates move more rapidly to reorganize inefficient or unproductive operations than single industry companies and to move their employees and capital into more productive uses; perhaps they simply do not throw good money after bad, as some single industry firms do; perhaps their ability to raise capital at less cost than smaller or less diversified firms enables them to use more capital-intensive technology; or perhaps, simply, the internal capital markets of conglomerates in a day of shortened product life cycles work more efficiently than in impersonal capital markets.

Perhaps, as the former president of I.T. & T. explained:

> Such a company has numerous individual specialists and experienced managers in many fields, and the very untraditional outlook that such a company brings to an industry is the key to innovation and new progress.

When Mobil acquired Montgomery Ward—which has gotten a certain amount of notoriety—it loaned its credit management specialists from its credit card department to improve Ward's troubled credit operation. It also loaned its real estate experts and location specialists from its filling station location group to Ward's store location group. Also, it applied its retailing expertise and purchasing knowhow to Ward's operations and improved the overall operation of the Montgomery Ward Co.

Whether conglomerates increase the efficiency of the American economy is a question that has baffled many observers. As one observer asked in opening the hearings on S. 600 in March of last year, he said, "How can putting cigarettes and Hawaiian Punch under one corporate umbrella have any startling effects on efficiency?"

Whether or not the answer is apparent to the naked eye is irrelevant. If our capital, labor, material, and product markets function competitively—and I believe they do—they will accord rewards to those who are efficient, and they will trim out the inefficient managements. And rewards and penalties have been meted out.

Some acquisitions have been mistakes. Some conglomerates have over-reached themselves, and some large firms have over-expanded in times past, but the market has cured that situation. Would-be giant conglomerates which failed to manage acquired assets as well as others could have, such as the Whittaker Corp. and Ling-Temco-Vought, have been forced to disgorge some of their acquisitions and reorganize their operations to stay alive. American Brands, W. R. Grace, and other conglomerates have sold many portions of their acquisitions to confine their operations to what they can manage well.

Professor Shepherd of Michigan State has found that many mergers are divestitures. I quote Professor Shepherd:

> Many mergers are divestitures rather than a combination of two free standing companies. Such selling off of branches rose in 1975 to 54 percent of all acquisitions (by number), up from 11 percent in 1967 and 39 percent in 1973.

In my study, what did surprise me was the evidence of greater relative efficiency of conglomerates and that the evidence showed so strongly in the data. On average, acquirers have improved asset management; they have yielded stockholders of poorly managed firms who were getting a less than competitive return an improvement in the value of their holdings; they have reallocated capital and labor from less productive to more productive uses; and they have improved the economic health of the country.

[Professor Brozen's written testimony was taken from his book Industrial Concentration and Public Policy (New York: MacMillan 1980), Chapter 11.]

Mr. **Bedell**. Thank you very much, Mr. Brozen. We appreciate the brevity of your remarks as well.

Who wants to be next?

TESTIMONY OF ROBERT HESSEN, HOOVER INSTITUTE OF WAR, REVOLUTION, AND PEACE, STANFORD UNIVERSITY, PALO ALTO, CALIF.

Mr. **Hessen**. My name is Robert Hessen from the Hoover Institution and the Graduate School of Business at Stanford University.

Thank you, Mr. Chairman, for this opportunity to testify on the subject of conglomerate mergers.

Before I turn to the specific impact of conglomerate mergers upon local companies and jobs, I would like to look at the issue in a slightly broader perspective.

In my opinion, having done extensive reading in the literature on conglomerate mergers, the entire subject is enmeshed in murky concepts and highly contradictory claims. First of all, what is a conglomerate? We are told it is a merger of two ostensibly unrelated economic enterprises, and we are given examples like this:

that a major tire company now owns radio and TV stations, or that a car manufacturer now makes coffee in Brazil.

The reaction of some people to hearing these examples is that these companies have gone far afield; they do not know what they are doing. I cannot discover any reason, however, why diversification is an evil or a calamity or something to be interfered with by congressional legislation. I see no reason why a company needs to continue operating exclusively in its original field of activity. It may be in a dying field. The tobacco companies, for example, have, in recent years, been diversifying into food products and many other lines of business, knowing that tobacco — I hope — is a waning industry.

There is no reason, therefore, why diversification is not a legitimate motive for a company moving into an entirely new field and bringing its expertise to those fields. Far from being a calamity or an evil, diversification makes good sense for companies, just as it does for individual investors and for mutual fund managers.

The attack on conglomerate mergers is extremely confusing. What precisely is the complaint? One of the people attacking conglomerate mergers is Senator Edward Kennedy, and he writes:

> Independent enterprises are increasingly absorbed within the corporate umbrella of conglomerate giants to which they may bear no logical economic relationship.

Presumably, a logical economic relationship would mean that a company was merging with one of its competitors, or one of its suppliers, or one of its distributors. But these options have virtually been sealed off by Congress (except in the case of acquiring a failing company) which means that, through the ban on horizontal and vertical mergers, Congress has, in fact, created the problem or given the impetus to the wave of conglomerate mergers which have swept the economy in the last 20 years. The irony, therefore, is that Congress is now being asked to cure the very problem which Congress, in my opinion, largely caused.

We are told, further, that conglomerates have an anticompetitive effect. Why? Because if such mergers are barred by law—as some people are proposing—then a conglomerate might start up a new company of its own in that unrelated industry? This strikes me as being a contradictory claim. On the one hand, if a company enters into an unrelated field of enterprise, that is illogical and bad; it is wandering far afield. On the other hand, if it wanders far afield but starts a brand new company, that is good. So you have the same action; good and bad. This is a "heads I win, tails you lose" kind of argument.

The more I read on the literature of conglomerates, Mr. Chairman, the more I encounter contradictory claims which cancel each other out. Let me give you one or two examples.

Are the critics claiming that a merger is harmful to the smaller company being acquired, or is it harmful to the other companies in the same industry which are not being acquired? Is the problem that surviving independent companies will not be able to compete effectively against a subsidiary of the conglomerate, or is the problem that the company being acquired will not be able to compete itself because it is being drained of its working capital by the new parent company?

The answer is—and we saw some examples this morning—you will find all of these claims and numerous others being made by critics of conglomeratres. They are simply unwilling to concede the possibility that a conglomerate merger could have a beneficial effect for the company being acquired, for the owners, that is, the people who voluntarily agree to sell their company to a conglomerate, and a beneficial effect, as well, for the new conglomerate parent.

In my opinion, a conglomerate merger can have a highly beneficial effect both on the company being acquired and on the new parent company. The parent company can often revitalize the smaller company by supplying it with money to improve or modernize production methods, or it can introduce new techniques for production or for quality and cost controls or new incentive systems for workers and managers, and generally provide assistance in the areas of production, advertising, marketing, and finance.

The first witness this morning, Mr. Harrison, talked about when he was a boy he used to buy one thing from Wilson and now Wilson is making something else. In fact, years ago, James Ling of Ling-Temco-Vought bought control of a family-owned enterprise, the Wilson Co. He split the big, inefficient, lethargic company into three parts: they made meat products, and pharmaceutical goods, and sports equipment and were known as "meatball, goofball, and golfball." Mr. Ling broke up the company into three independent parts. He brought in specialists in these various fields. He, by the way, got rid of most of the superannuated personnel as well as the nepotism of sons-in-law and nephews flourishing in the business and he revitalized the three operations and then created new competitive challenges in those industries.

I think, Mr. Chairman, that one of the fears about conglomerate mergers is precisely that they will intensify competition rather than eliminating or reducing it. The fear is that an aggressive and ambitious newcomer to the industry, a firm that is not committed to doing "business as usual," will come in and revolutionize that industry. I heard, as corroboration, examples this morning of companies that come in and do things in an unconventional or innovative way.

So, we have the paradox of companies turning to you, Mr. Chairman, trying to get you to create legal barriers to entry, trying to get you to rope off existing industries against the entry of outside firms. If truth in labeling were to apply, I think that the attempts to restrict conglomerate mergers should be called "the Anti-Competitive Act of 1980," or whatever year this might be passed.

I see I have 2 more minutes and would like to make a couple of additional points.

I am a historian by training. My specialty is American economic and business history. Studying the 1880's and 1890's, I have discovered that the exact same arguments were being made then that are being made today against conglomerate mergers. At that time, people turned to Congress, or the State legislatures, to do the very thing that different people a century later are asking Congress to do right now; that is, to worry about the impact on local jobs of new industries.

We have had many times in this country's history when new technologies rendered old methods of production obsolete; that is, less efficient in terms of cost, and therefore older firms would go out of existence; papermills, sugar refineries, and countless other kinds of businesses which could not keep pace with new methods of production went bankrupt, and their workers had to relocate in some cases.

I can imagine 100 years ago if Congress had chosen to intervene we would have a great many labor-intensive industries being perpetuated for the sake of protecting existing jobs, and we would have a substantially lower standard of living than we do now. Change inevitably results in economic dislocations. They are hard for individuals. William Carnegie, the father of Andrew, left Scotland because as a handloom weaver, he could not compete against power-driven looms; it was a misfortune for him but his son came to this country and created thousand of jobs in the steel industry.

Another example of an industry which 100 years ago people complained was taking jobs away from local firms was the mail order business. Sears Roebuck, Montgomery Ward, and other companies began to transport goods in interstate commerce through the mails. Local merchants complained to Congress that they were losing sales to these out-of-town sellers, and they urged Congress to forbid the shipment of merchandise through the mails. They tried, in other words, to create a legal barrier to entry. But the effect of these outside firms coming in and selling merchandise by mail was to give local consumers a far wider range of choices than they ever had before.

Finally, as an example, in the 19th century when a railroad chose to build a depot between one city and another, from A to B instead of from A to C, C, which had hoped that the railroad depot would go there, was a city that went into a state of decline. Things that had been built in anticipation of the depot being built there were dismantled. Companies might move out or relocate or close down and move to area B.

My point is that all kinds of changes will result temporarily in dislocations. I think what Congress has to be wary of is the idea that there should be a moratorium on change, a moratorium on innovations, and a moratorium on competition. You can protect all existing jobs, and you can protect all existing small companies, but you will do so at the price of the standard of living that most Americans value.

Thank you.

[Professor Hessen's prepared statement follows:]

Prepared Statement of Robert Hessen, Hoover Institute of War, Revolution, and Peace, Stanford University, Palo Alto, Calif.

Mr. Chairman, my name is Robert Hessen. I am a Research Fellow at the Hoover Institution at Stanford University, where I also teach in the Graduate School of Business. For the past fourteen years I have been studying, teaching and writing about American economic and business history. I am here today at your invitation to present my views on conglomerate mergers and whether any type of remedial legislation is needed.

In the few minutes which you have allotted to me today, I will discuss why S. 600—the "Small and Independent Business Protection Act"—which Senator Edward Kennedy introduced on March 8, 1979, is misconceived. I will also challenge the broader underlying premise that conglomerate mergers are injurious to small business.

I have three objections to the Kennedy bill. First, it is based on exceedingly vague criteria and it gives vast and unchecked discretionary authority to the Attorney General and the Federal Trade Commission to determine whether a proposed merger will satisfy the "affirmative defenses," that is, will substantially enhance competition or result in substantial efficiencies. Second, the proposed Act is based on figures that simply have been pulled out of the air; they are completely arbitrary. Third, the bill represents a "foot in the door" strategy—once the principle of restrictions on conglomerate mergers has been enacted into law, there will be no possible way for anyone to argue effectively against extending those restrictions to smaller companies. The whole issue will then become one of quibbling about details, but there won't be any logical stopping point until all conglomerate mergers fall within the scope of the law. Before Congress takes a step in that direction, let's first examine whether conglomerate mergers are actually harmful.

In my opinion, the whole subject of conglomerate mergers is riddled with murky concepts and contradictory claims. What is Senator Kennedy's definition of a conglomerate? In his statement of March 8, 1979, he defined it as "the merger of two ostensibly unrelated economic enterprises," and he offered these examples: "A major tire company now owns radio and television stations, an airline, and a soft drink company. A car manufacturer makes coffee in Brazil . . ."

Perhaps your reaction to hearing these examples is that the situation is evil per se. But I can discover no reason why a company must be limited to a single line of activity—even ignoring the difficulty of defining those lines—nor why it must slavishly cling to its original field of activity. Diversification is a legitimate goal for any company, because it reduces its dependence upon any one line of business. Far from being a calamity or an evil, diversification makes eminently good sense for a business firm, just as it does for individual investors.

If we hear no complaints when individuals diversify their investments, then why should anyone complain when companies make the same decisions and for the same reason? If one grants this freedom of choice to individuals, then on what grounds does anyone propose to deny it to companies? After all, companies are groups of individuals, and individuals do not forfeit their rights when they join together in voluntary enterprises.

It is ironic that conglomerates are condemned for doing the very thing for which mutual fund managers are praised. If the managers of a mutual fund were to place all of the investors' capital in a single company or industry, they would be criticized for failing to spread the risk over numerous investment opportunities. Then what objection can there be if, to use Senator Kennedy's example, the officers of a tire company acquire control over radio and television stations, or an airline or a soft drink company? Why is diversification a virtue for mutual funds and individual investors, but simultaneously an evil for conglomerates?

The attack on conglomerates by Senator Kennedy, Ralph Nader and other critics is quite confusing. What precisely is their complaint? Senator Kennedy said that ". . . independent enterprises are increasingly absorbed within the corporate umbrella of conglomerate giants to which they may bear no logical economic relationship." Presumably a logical relationship would exist if a company were merging with a competitor or with one of its suppliers or distributors. But these options virtually have been sealed off by Congress—through the ban on horizontal and vertical mergers. Conglomerate mergers have been triggered by the antitrust laws, so ironically Congress itself is the cause of the alleged problem it is now being urged to remedy.

Senator Kennedy says that conglomerate mergers have an anti-competitive effect. Why? Because if such mergers were barred by law, then a conglomerate might start up a new company of its own in that unrelated industry. In other words, a company's entry into an unrelated field is illogical and therefore bad, except when it enhances competition and is therefore good. Senator Kennedy's position sounds like: Heads I win, tails you lose.

The more I read in the literature on conglomerates, the more I encounter contradictory claims which cancel each other out. Let me give you one or two examples. Are the critics claiming that a merger is harmful to the smaller company being acquired, or to the other companies in the same industry which have not been acquired? Is the problem that the surviving independent companies will not be able to compete effectively against the subsidiary of the conglomerate? Or is it that the company being acquired won't be able to compete, because its working capital will be drained off by the new parent company? The answer is that you will find all of these answers in the writings of the critics. They are simply unwilling to even conceive the possibility that a conglomerate merger might be beneficial.

But a conglomerate merger can have a beneficial effect, both on the company being acquired and on the local community in which that company operates. The parent company can often revitalize a smaller company by supplying it with money to improve or modernize its production methods, or it can introduce new techniques for quality and cost controls, or new incentive systems for workers and managers, and generally provide assistance in the areas of production, advertising, marketing and finance.

In answer, critics of conglomerates sometimes point out that this revitalization and growth is achieved at the expense of competing firms. These other companies are placed at a competitive disadvantage, it is claimed, because they don't have access to similar assistance. I find that objection unpersuasive as a reason to block conglomerate mergers. The other companies are not entitled to a perpetuation of the status quo forever, and they have no moral or legal right to demand a moratorium on the introduction of new money or new managerial methods into their industry. They must adapt themselves to keep pace with the enhanced competitive challenge, rather than turning to Washington to insulate them from competition.

Today, Mr. Chairman, conglomerate mergers offer the greatest promise of increasing and intensifying competition within industry. They are feared primarily because they threaten to disturb the status quo. If a company is mismanaged or failing to achieve its full profit potential, it is likely to be the target of a takeover attempt. But if Congress extends the scope of the antitrust laws to restrict conglomerate mergers, incompetent managers will be immunized against the sanctions of the marketplace.

Similarly, other firms in the same industry feel threatened by the proposed entry of ambitious and aggressive outsiders, people who are not committed the perpetuating "business as usual." So they, too, ask Congress to put the brakes on conglomerate mergers. The irony is that Congress, which presumably seeks to promote and preserve competition, is being asked to create a legal barrier to entry and thereby impede and discourage new competitive challenges.

I hope that you will see through the rhetorical label of the "Small and Independent Business Protection Act" to the fact that the proposed legislation will have a profoundly anti-competitive effect.

Mr. **Bedell**. Thank you, Mr. Hessen.

Mr. Benston?

TESTIMONY OF GEORGE BENSTON, UNIVERSITY OF ROCHESTER, ROCHESTER, N.Y.

Mr. **Benston**. Thank you, Mr. Chairman.

I completely agree with what the two previous speakers have said, and it is certainly consistent with the research I have read and some of which I have done.

Basically, there are several aspects I would like to touch on. One is the data about the increasing concentration of industry that the Federal Trade Commission puts out. There are, in some of the written testimony that I have presented, some remarks on the claim that big business is taking over the entire country.

Mr. **Bedell**. Do we have your statement?

Mr. **Benston**. It is an enormous thing. I am sure you do not want me to read it. But you have it.

The numbers are there, but rather than read numbers, which no one can absorb anyway, I will just talk about them if I may.

Mr. **Bedell**. That will be fine.

Mr. **Benston**. Basically, what is called the aggregate concentration ratio is basically misleading numbers. The FTC constructed ratio concentrates on manufacturing when we have had shifts away from manufacturing into other areas, and it also concentrates on industries that are characterized by large economies of scale; that is, very large plants and equipment. So, a desire for a lower ratio is equivalent to saying that we do not want large industries, that we do not want automobiles but want to walk instead, that we do not want steel, or integrated oil companies but smaller companies. Large company size often is a function of the mechanics of making goods.

Further than that, there is quite a bit of turnover among those companies. We do not see the same 50, 100, or 200 companies continuing over time. They lose their position. And there is also no evidence at all that smaller companies in the economy are declining relatively.

There are a lot of biases in the aggregate concentration ratio that I have gone into in my written testimony; I will not go into these problems right now. But these are very severe biases, and, in fact, when the numbers are looked at without those biases, even assuming that the ratio meant anything, it could be seen that it is not increasing over time. When one takes account of the turnover, of the so-called top companies, it is even quite the other way around: companies go in and out of those top 100 and 200 companies.

But the most important thing, I think, that I would like to concentrate on, is the benefit to small businesses of mergers, because that is, after all, what I presume to be the major concern of this subcommittee.

Essentially, as Mr. Birch mentioned, a lot of the new growth comes about for small businesses from entrepreneurship: of people having an idea, of being willing to take the risks of putting everything they have got into attempting to make something happen. It is one of the geniuses of the economy and one of the things that we have all benefited from, that people are willing to start a business—to risk their time, their money, their relatives' money, and to try to do something and make it work.

One of the rewards of the effort is the ability later, should the business succeed, to diversify their portfolios—their holdings—into something else. Namely, if you put all of your eggs in one basket, in one particular business, you risk a total loss. In addition, one of the rewards of entrepreneurship is being acquired by a larger company, which enables a small businessperson to diversify his or her holdings into a variety of assets. So, instead of having, when the entrepreneur dies, should that occur, enormous inheritance tax problems and success, the entrepreneur's heirs can get marketable securities that can be sold without dissolving the business.

Usually the person who starts a small business has a specific kind of specialty, they are very good in marketing or production or have a particular idea. But to get the wide range of skills it might take to develop that idea even further, very often the most effective way to get these things is to merge in with a larger company and to get them through the conglomeration with that larger company.

Also, it often is not very efficient for the larger company usually to start up a new business because that is what entrepreneurs do; they are the ones who are willing to take the risks, but they also want the rewards from that risk—the payoff.

So, if one stopped mergers or constrained them—conglomerate mergers or any other kind—one would be very severely hurting small business because the opportunities for a small business person to be able to get the expertise, access to capital markets, diversify personal holdings, and do a whole series of things would be very severely constrained. I think that would be very detrimental to all of us.

Indeed, when one looks at the aspects of who benefits and who loses from the mergers, the one thing we know from a number of studies that have been done is that the shareholders of companies that are merged in almost always benefit. The percentage increase in their shareholding values goes up tremendously.

There are a lot of reasons why mergers occur and do not occur, but one thing is almost certain: it benefits the smaller businesses that are being merged. Remember, nobody has to merge with somebody else; it is not a requirement imposed by someone, but a voluntary action taken by vote of the shareholders who decide to accept an offer that somebody else makes for their shares or for their entire corporation.

Does it hurt the workers in those cases? Again, we heard this morning of a whole variety of studies that appear to show that plant closings hurt workers. Surely they do, and surely a business that goes out of business hurts the people involved and the communities. But there is no evidence that I know of showing that plant closings are particularly due to mergers. In fact, some recent census data would indicate that plant closings and worker losses are much higher in single unit establishments than multiunit establishments. In a sense, this is obvious: a multiunit establishment has more alternatives to work with. This does not mean that such companies do not make mistakes; surely they do. If one could operate without mistakes, it would be a fantastic and marvelous world; one would like that.

The question is not really whether they make mistakes but where mistakes are more likely to happen. Are fewer mistakes made by an outsider—say—a professor from MIT or the University of Rochester, or Stanford, or Chicago—coming in and saying, "I think you are running your business wrong, and I can tell you how to run it better"? Or by the people on the job actually deciding what is best for them?

For example, one has heard the example of the Colonial Press. I have read the testimony and heard it. The company came in and said they were going to revolutionize printing, and they did not. What if they had, and it turned out that they achieved a marvelous innovation, and, in fact, they increased productivity and sales tremendously? Nobody knows in advance which ideas are good or bad. We do know, though, that decisions are best made by the people in the individual enterprises, by the small business people involved, such as to whether to merge with a larger company or not. To allow them to make those decisions has been, I believe, the genius of our economic system that has benefited workers but mostly consumers, because we are all consumers.

One other point I would like to close on—to stay within the time limit—is this. I have heard the testimony this morning about the very severe personal problems that individuals suffer when a business changes. Any sort of change is painful to somebody; that is certainly true. And the word that economists use is an "externality." That is, there is some effect, some cost that is borne by people other than the ones who make the decisions. The workers involved in the closing or in the merger do not make the decision; the stockholders do; nevertheless, the worker may bear some of the costs. And they probably do bear some of the costs; there is no question about it. And it is very sad if anyone should commit suicide, or lose their wealth, or have their marriages break up, or suffer other kinds of dislocation; it is a very sad situation—no question.

The question is this, though. We have to choose, not between perfection and imperfection, but between various degrees of imperfection. What happens should we stop change from happening? Should there by a moratorium on plant closings, or a moratorium on mergers? Should there by a situation where the people who have their jobs would have them guaranteed? What would the cost be then?

Surely we know—as we have just heard—that the cost would be very great for consumers in this country. It would be very great for the entrepreneurs who put everything into making a success, but when they make it are told that some law prevents them from diversifying their own holdings.

It would be very difficult for the people, who, in a sense, stagnate. We have seen situations of stagnated economies, where people keep their jobs all right, but they have no chance to grow and change.

One of the costs of an economy that allows freedom of choice is that some of the choices turn out to be bad ones. I believe personally, and I hope Congress believes, that it is still much more preferable to have a situation where some mistakes are made and where some people bear costs, than to have the alternative situation where even more mistakes are made because the decisions are being made not by the people whose lives are at stake, and whose wealth is at stake, and whose specific positions are at stake, but by professors, like myself, who are, in fact, teaching and not in business, or people from the Federal Trade Commission, or people in the Congress. Decisions, I submit, are best made by individuals in the field making their choices in terms of what they think is best for themselves at that particular moment. It is that which has been the genius of our economy and given us a great standard of living and an awful lot of freedom. And it would be detrimental to us all, I believe, should that be changed by laws which restrict change from occurring.

Thank you.

[Professor Benston supplied the Antitrust Subcommittee with his study Conglomerate Mergers: Causes, Consequences, and Remedies, published by the American Enterprise Institute, Washington, D.C., 1980.]

Mr. **Bedell**. Thank you, Mr. Benston.

Mr. Hanley?

Mr. **Hanley**. Thank you, Mr. Chairman.

Mr. Benston, you related to voluntary mergers. In fact, you said they are all voluntary. There are, of course, hostile mergers.

What is your attitude toward the hostile merger?

Mr. **Benston**. When I said "voluntary," I was talking about the owners of the enterprises as compared, sometimes, with the managers of the enterprises.

The managers may be hostile for several reasons. One is that they may not want a merger because they really feel it is not in the interests of their shareholders. In fact, one of my colleagues, Michael Bradley, just finished his dissertation on this, I believe under Yale Brozen, which shows you that we are, perhaps, too close a world. He found that, indeed, sometimes the managers who have opposed the mergers have done so in the interests of their shareholders. That is to say, a later merger offer was even better for the shareholders.

So, we cannot conclude that a hostile situation is necessarily a bad situation.

But there are also the other aspects. Some managers do badly. They are human beings too, and they do not want to lose their jobs. So, they do not want a merger to occur, not because they are trying to protect their communities, or their workers, or their stockholders, but themselves. The essence of the market for corporations, basically, is that stockholders are tendered offers for their shares, which provides a means of overthrowing the bad managers.

Mr. **Hanley**. I personally do not have a prejudice one way or the other. Like all members of this subcommittee, I am searching here. But I do recall in my own home community, Syracuse, N.Y., recently a major merger that was classified as a hostile merger, one that was fought vigorously by the Carrier Corp., which was taken over by United Technologies.

There was a very, very negative reaction initially on the part of the owners, if you will—the stockholders. And, of course, management itself resisted. Ultimately, the pendulum swung in the direction in which most anticipated that ultimately it would.

So, I was interested in knowing whether or not your philosophy with respect to mergers remained the same regardless of this situation or a completely compatible one from the beginning.

Mr. **Benston**. I think an important distinction has to be made. It is something we do not really know in advance—whether it is hostile because the managers think it is better for the shareholders and the employees to wait for a better offer to come along or because they want to protect their own jobs, and they had not been running the company well, and therefore they simply want to keep their jobs at the expense of the rest of the people in the company, particularly the shareholders.

It is very hard to know these things in advance, and even afterwards. I guess my philosophy would really say that I am willing—that is, I would hope that the Congress and the country would be willing to accept situations that, in fact, turn out badly because, in general, most of them turn out to be good; the shareholders get information; they can vote; they do not have to tender their shares if they do not want to.

Mr. **Hessen**. Mr. Hanley, I wonder if I might supplement the point from another aspect?

Mr. **Hanley**. Please do.

Mr. **Hessen**. When a privately held company is sold, obviously, the owners do consent, or at least the majority do consent and agree to turn over control of the company. But now let's take the case of a publicly traded company—and we can use the recent example of McGraw-Hill which American Express tried to acquire.

The McGraw family has controlled the company since its founding, and they wanted to retain control.

If a company remains privately held, the owners thereby guarantee themselves against a hostile takeover. However, if they go public, that is, if they allow shares of their stock to be traded on public exchanges, then the know that one of the inherent risks of being a publicly traded company is that someone or some coalition of people, can buy enough stock to be able to elect one or more directors and ultimately to change the policies and the personnel of that company.

If they want to avoid that risk, which is a known risk (like the risk that if you go into a gambling casino you may lose), they can do what the Ford Motor Co. did when it went public years ago; they created two classes of stock, one a voting class, in the hands of the Ford family and the Ford Foundation, and the other a class B stock, with no voting rights. Class B shares could be freely traded, and there would be no possibility of an adverse takeover.

Or they could, alternatively, create a voting trust so that the majority of the stock was in the hands of a foundation or a trust for the benefit of the beneficial owners, or the workers, or anybody else. There is a variety of options to keep a company, even a publicly traded company, from an adverse or hostile takeover without needing to ban conglomerate mergers.

It is overkill to ban conglomerate mergers. There are much more specific remedies which any good lawyer could recommend to a company to protect itself from the possibility of a takeover.

Mr. BEDELL. Would the gentleman yield?

Mr. HANLEY. I would be delighted to yield.

Mr. BEDELL. I get the impression from the witnesses that they think this subcommittee is planning legislation to ban corporate mergers. As far as I know, there is no such feeling on the part of the subcommittee. We are looking at some problems that exist, but at least as chairman of the subcommittee I know of no one on this subcommittee who is actively pursuing such an effort.

Mr. HESSEN. Mr. Chairman, I will tell you the reason I think the three of us are somewhat suspicious.

There is S. 600. There is a very prominent American figure, Senator Kennedy, who introduced it. There is a whole issue of the "Antitrust and Law Review" devoted to what form of legislation there should be. The Antitrust Division has one bill it is sponsoring; the FTC has another bill it is sponsoring; Senator Kennedy has a third version; Ralph Nader has a fourth. There seems to be such an overwhelming mandate in this country to do something about the problem of conglomerate mergers that we suspect that where there is smoke there is fire; where there are bills, there is a tendency to want to enact one of them into law. And we are hoping to put on the record—I speak for myself only, but I assume the other gentlemen concur—some skepticism about the wisdom of the proposed legislation.

Mr. BEDELL. The effort of the subcommittee is to try to learn as much as we can about the problems caused by conglomerate mergers, if the gentleman would yield further.

Mr. HANLEY. I would be delighted.

Mr. **Bedell.** I speak for myself, but one concern that exists is this. The subcommittee is trying to look at the problems caused within our society, particularly as they affect communities and the people in those communities. Your concerns, if I read the testimony of the three of you correctly, has to do with the economic activity—what it does for the stockholders and what it does in terms of our total economy—as compared to that particular problem of local communities that we have been trying to look at.

I believe, as a Member of Congress elected by the people, that I have a responsibility to look at the social impact of what effect these mergers are having in terms of our entire society.

I thank the gentleman for yielding.

Mr. **Hanley.** I thank the chairman for clarifying the purpose of this forum. I will just make one other observation.

I am privileged to also sit on the House Banking Committee which, as you know, had jurisdiction over the Chrysler loan issue. During the course of that rather long deliberation, there were some observations made in the sense that the American economy is leaning on this industrial giant. If it happens to go up the chimney, the whole economy—God forbid—could come tumbling down. That is rather an awesome predicament to be in.

A further observation was this. At one time in America there were well in excess of 100 automobile manufacturers all vying for their place in the marketplace, each competitive with one another. To negate the possibility of the American economy finding itself in this kind of position, would it not be better if the industry was diversified, as it was some years ago? Perhaps the technology associated with the automobile would be far better than it is today, where you have in excess of 100 different sets of designers and engineers all competing with one another. Perhaps we would not have polluted air, as a result of the use of a combustible fuel in that engine. Many other improvements may have occurred long ago had that have been the case as opposed to the situation that did develop in our country resultant from the growth of that particular segment in the automobile industry.

Again, you had a situation where in the confines of one boardroom, if you will, was one dominating personality in that boardroom who happened to make a human error which ultimately proved the undoing of that corporation and, along with it perhaps, the undoing of the American economy, as opposed to a situation where there were in excess of 100 different boardrooms. Within the confines of 1 of the 100 boardrooms if somebody made an error, the result of that error would not be quite that traumatic.

I leave you with that observation, and I would be interested in your comments on it.

That was a part of our deliberation in recent months prior to the approval of the Chrysler loan guarantee legislation. Do you have any comments on that observation?

Mr. **Brozen.** I think it is a mistake, first of all, to look at any American industry as if it exists in isolation in this world. If we have just a few major automobile companies in this country, that does not mean that that is going to determine the course of automobile design because there are 35 other companies in the world who are also selling in the American market. If any of our corporate boardrooms make an error in the design of automobiles, there are 35 other sources of invention, innovation, and competitive offers of product design from outside the country.

Mr. **Hanley**. If the gentleman would yield at this point, it is not fair to say that the big three do not dominate the market. Do I recall, subsequent to World War II, a gentleman by the name of Mr. Tucker coming on with a highly decent concept of an automobile which was not allowed to live? Do I recall the demise of the Franklin Automobile Co. in 1934 which had a pretty good concept which was buried with its demise, which we should have in use in America today?

I would hope very much that you would not be telling me that the big three do not dominate the American automobile scene.

Mr. **Brozen**. That is precisely what I am telling you, Congressman.

Mr. **Hanley**. Then you and I differ. Please continue.

Mr. **Brozen**. Mr. Tucker's demise was because he never brought an automobile to market, and the Franklin automobile's demise was a consequence of the choice of consumers, not the choice of the big three.

Mr. **Hanley**. If time allowed, I would like to debate both issues with you, and I would spend a great deal of time on both industries.

Mr. **Brozen**. But this is a common story in all industry. We had 34 rayon companies in the United States in 1933, and we have a half a dozen rayon companies today. The story can be told over and over again. We had 137 bicycle companies in 1895 in the United States, and by 1910 we had less than a dozen bicycle companies.

Mr. **Hanley**. If the gentleman would yield, we had a lot of trolley systems in America until General Motors got into the bus business, and you know what happened to the trolley systems, which hindsight has it was a pretty good way of moving people. Our mass transit technology suggests that we should now be moving back to it. Again, by virtue of domination by General Motors from the standpoint of manufacture of buses, we soon lost the American trolley.

Mr. **Brozen**. Well, the bus was a superior alternative in the minds of those who chose to buy buses and discontinue their trolley systems.

Mr. **Hanley**. That is a matter of conjecture, but not really to the advantage of the American public. That has been proven.

Mr. **Brozen**. There are some opposite studies that would indicate that that point has not been proven, Congressman.

Mr. **Hanley**. I beg to differ with the gentleman; it has been proven. [See Appendix T.]

Forgive me. Proceed.

Mr. **Brozen**. That is all.

Mr. **Bedell**. Have you finished, Mr. Hanley?

Mr. **Hanley**. Yes, thank you, Mr. Chairman.

Mr. **Bedell**. We only have a few minutes.

I did not quite understand your statement, Mr. Benston. I thought you said that if anyone who started up a business could not then sell that business to a larger acquiring firm it would be more difficult for small businesses to start up.

Mr. **Benston**. It is not that everyone who starts a business will sell to someone else or intends to sell to someone else, but it is an opportunity.

Mr. **Bedell**. If that were not possible, if there were restraints on mergers, how would that in some way restrain someone from starting a new business? Was that your implication?

Mr. **Benston**. Yes, exactly.

Let us put ourselves in the position of someone who is thinking about starting a new business, who must take the risks involved. He has to get together money from friends and relatives and the bank, or whomever, or try to sell some stock perhaps, if the SEC did not impose too high costs on this activity. There is a higher probability that it will not succeed, and everyone knows that. But there is some probability that the business will succeed, that it will work out. Then you, the business person, has to say: "All right, if it does work out, what happens then?" If it works out, what will you do? You look ahead into the future.

One of the possible things to do, should it work out, is this. You now have an asset, but you can only develop it so far by yourself; sometimes it is best to get some more expertise or help.

Let us say you have a new product that is really going to be a good thing. If you can show it is going to be a good thing, then you can sell it, in effect, by merging with a larger company before someone else copies that good thing and takes it away from you. It is an opportunity that would be foregone if you could not look forward to merging with a larger company.

Mr. **Bedell**. I come with some prejudice because that is exactly what I have done—start a business myself. I hardly know of anyone who, when they start a business, start with the thought that they are starting it because they want to build it up to sell to a larger company. I just may not know the right people. If that is what our society wants, it is pretty scary.

If the incentive for people to start businesses is to start them so they then can sell them to a larger corporation, then the social concerns that have been expressed are all the more legitimate. They are saying that anybody who starts a business in a community starts it with the anticipation that it is going to be sold to outsiders who will come in with, what I think has been fairly well documented, somewhat less concern for the local community than the people who live there and develop their businesses. It sounds to me like a scary scenario.

Mr. **Benston**. Perhaps I did not explain the issue well enough. What I was trying to say was that while somebody doesn't start a business in order to sell it by merger, that is to say, it is not a single-minded process, it is a possibility that one can look forward to.

Mr. **Bedell**. You said that would be a deterrent to people starting a business, if I understood you correctly.

Mr. **Benston**. No. I did not say it was the deterrent, that is, without mergers there would be no small businesses.

Mr. **Bedell**. Oh—a deterrent?

Mr. **Benston**. It is a deterrent.

But even taking it one step further, the small business gets started because somebody just has a belief in a product, service, or process. Eventually these persons get to the point where they are getting older, and they may or may not have a child, who can and wants to take over the business. It is a matter of how far down the road you think somebody plans.

You may say from your own experience—and surely I cannot question that——

Mr. **Bedell**. If what you say is correct, God help us, that the reason people start businesses is to get them started so they can then sell them to outsiders who come into the community—and we have had testimony of the problems of outside ownership with less interest in the community—we had better look at a way to change this pattern.

Mr. **Brozen**. May I address myself to that question?

Mr. **Bedell**. Certainly.

Mr. **Brozen**. We have 13 million business enterprises in this country. Fairly obviously, they are not all sold out. They all continue to operate. But a factor in starting a business is getting a supply of capital. One of the things that eases the problem of getting a supply of capital is that, in case the business does poorly, there are people around who may acquire the assets of that business; there is an active market for assets. So, that decreases the risk to capital suppliers, to the lenders, banks, the minority stockholders who may put up some of the funds required to start the business. The risks to them are smaller simply because if a poorly operated business does not succeed, it nevertheless has some assets, and there is an active market for assets; they can be bailed out, then, in that active market for assets.

We have taken a look at the kind of acquisitions that are made by companies, and on the average the acquisitions made by companies are of other companies that are not doing well.

Mr. **Bedell**. Mr. Birch indicated just the opposite. He indicated his study showed that most mergers were acquisitions of the more successful growing companies.

Mr. **Brozen**. My sample is a specially selected sample in this sense: It is all New York Stock Exchange listed firms that were acquired by other firms.

Mr. **Bedell**. I think we are not talking about firms of that size. We are concerned for the smaller firms and their impact on local communities.

Would you like to take the chair, Mr. Hanley? Our time has expired.

Mr. **Hanley**. I am sorry, but I do have a conference.

Mr. **Hessen**. Could I take 2 minutes?

Mr. **Bedell**. If we limit it to 2 minutes. I have to leave immediately.

Mr. **Hessen**. There is a point you made, Mr. Chairman, that I would like to clarify. You implied earlier that the three witnesses were essentially presenting the economic argument, and you were really considering the social impact.

Mr. **Bedell**. That is correct.

Mr. **Hessen**. I would not care to leave it as an issue of money versus men, or efficiency versus justice. I think what you have to bear in mind is that on both sides of the issue there are individuals involved who have certain rights and expectations.

When a new company is created in a given area, there is no guarantee in perpetuity to the workers that the company will prosper, or remain in the original line of business, or remain in the hands of the original family. The owners or their heirs have the right to sell, to liquidate, to move away, to diversify their holdings, to change the character of the business; to go from shoemaking to typewriter construction.

I think what you have to bear in mind is that on both sides there are issues of social impact. That is, do you, the Congress, want necessarily to favor the interests of workers at the expense of owners, investors, managers, or consumers? There are people on both sides; the choice is not money versus men.

Mr. **Bedell.** Let me say that I have a feeling we have put far too much emphasis on helping the stockholders, the business owners, and so on, who, I believe, do not need the help nearly as urgently as do the communities and the individuals. That may be a prejudice, but it really worries me if we have a society that says the people we are going to worry about the most are the people who have the most, and the people we are going to worry about the least are the people who have the least.

In my opinion, owners of large businesses tend to be in better economic shape than those people who are dependent upon that business for their jobs, or the communities that are just torn apart by those mergers.

We are short on time here. We appreciate your coming here. It is testimony we wanted to have because we want to hear views that might be different than those we might have in our own mindset. On the other hand, I think it is only right that we try to look at these issues and ask how they affect our entire society.

Thank you very much for being here.

The subcommittee is adjourned.

[Whereupon, at 12:15 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

WEDNESDAY, FEBRUARY 27, 1980

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2359-A, Rayburn House Office Building, the Honorable Berkley Bedell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN BEDELL

Mr. **BEDELL**. The subcommittee will come to order.

Today we resume our hearings on conglomerate mergers and their effects on small business and local communities. This is the sixth in a series of hearings conducted by the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business.

Our witnesses today are two distinguished public servants, Harold Williams and Robert Hall.

Mr. Williams is the Chairman of the Securities and Exchange Commission. He and his fellow commissioners have given considerable thought to the subject of conglomerate mergers, and we look forward to his testimony.

Mr. Hall is the head of the Economic Development Administration, a branch of the Department of Commerce. The EDA frequently is called upon to assist communities that have suffered economic dislocations. A new and growing role for EDA is to assist in financing the acquisition of plants or divisions being divested by conglomerates.

When we opened these hearings, several of our case studies involved spinoffs and plant closings where EDA assistance had been sought. We will discuss these and others matters with Mr. Hall.

We are pleased to have Congressman Williams with us.

Do you have a statement to make?

Mr. **WILLIAMS** of Ohio. Mr. Chairman, I just want to thank you for allowing me to sit on the subcommittee. You know, my State has been impacted greatly. I appreciate your foresight. I look forward to the testimony.

Mr. **BEDELL**. We have a practice of swearing in the witnesses. Would you stand, please?

Do you solemnly swear that the testimony you are about to give this subcommittee will be the truth, the whole truth, and nothing but the truth?

Mr. HALL. I do.

Mr. HAROLD W. WILLIAMS. I do.

Mr. KARRAS. I do.

TESTIMONY OF ROBERT T. HALL, ASSISTANT SECRETARY FOR ECONOMIC DEVELOPMENT, DEPARTMENT OF COMMERCE; ACCOMPANIED BY HAROLD W. WILLIAMS, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC DEVELOPMENT; GEORGE KARRAS, DEPUTY ASSISTANT SECRETARY FOR OPERATIONS, ECONOMIC DEVELOPMENT ADMINISTRATION; AND EDWARD M. LEVIN, JR., CHIEF COUNSEL, ECONOMIC DEVELOPMENT ADMINISTRATION

Mr. HALL. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to have the opportunity to testify before the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business.

As you noted in your invitation, the Economic Development Administration, EDA, does play an important role in assisting communities to recover from economic dislocations such as the closure of a major employer.

In my testimony, I would like to share with the subcommittee some of EDA's experiences in assisting communities impacted by economic dislocations, particularly those resulting from the divestiture of a company by a conglomerate corporation.

The primary mission of the Economic Development Administration is to address the problems of chronic high unemployment and low per capita income in economically distressed urban and rural areas of the country. EDA carries out its mission by making investments aimed at stimulating the creation of permanent, private sector jobs in such areas.

More specifically, EDA provides grant funds to help develop public and private institutional capacities, to provided technical assistance and economic information, to build public facilities, and to rehabilitate older, useful structures, to acquire land, and to provide, either directly or through Federal guarantees, investment capital for private enterprise.

In 1974, Congress recognized that preventing economic dislocations is as much a part of effective public sector economic development action as initiatives to deal with long term structural economic problems.

As a result, Congress gave EDA through the Title IX amendment to the Public Works and Economic Development Act (PWEDA) of 1965, the basic tools for coping with actual or threatened economic dislocations, whatever the cause.

In response to that amendment, the Office of Special Adjustment Assistance was set up in EDA.

Our special responsibilities include responding to sudden and severe economic dislocations for areas either impacted, or threatened, by events such as a plant closing or a sharp cutback in production and employment.

We also respond to military base closings, or the establishment of new defense installations, which can spawn a boomtown syndrome that can have deep and abiding impacts upon a community.

Title IX has the advantage of giving EDA great flexibility in being able to respond to actual or threatened dislocations. The Title IX program is intended to help local areas, urban or rural, develop and implement economic adjustment plans.

We try to anticipate and solve serious adjustment problems before they can undermine local economies. If we cannot, it is then our job to assist the affected community to reestablish employment opportunities and economic stability as soon after the dislocation as possible.

In a sense, the economic adjustment program authorized by Title IX presents a concentrated, speeded-up view of economic development, as seen and practiced by EDA.

A good example is the case of a firm in Georgia which employed about 900 workers. Located in one of the poorest counties in the State, its ability to provide work and income to the area is tremendously important.

The parent firm, a large conglomerate, tried to sell the subsidiary. When it could not locate a buyer, it announced that it would close the facility and liquidate the assets. This decision would have had serious repercussions on the local economy, not to mention the families dependent on incomes generated by the business.

At the invitation of the community, working through an EDA-supported economic development district, aid was sought from EDA to prevent plant's closure. In this case, the employees requested EDA assistance to purchase the firm themselves.

The means by which this was accomplished is not as important as the side effects. What EDA did through its Title IX program was to grant sufficient funds to the economic development district, which in turn lent the money to the newly formed Employee Stock Ownership Trust, or ESOT.

This action succeeded in leveraging and loans from local banks; provided the means to purchase and reorganize; and set up a revolving loan fund which, because of repayments, could be used over and over for other development projects in the area.

Not only has the original adjustment venture been successful—the firm has since added to its 900-member payroll—but at least four other firms in the community have been saved or expanded, creating new economic activity and jobs.

I could recite several other examples in EDA's experience, some similar with regard to the techniques used, others quite different. But there are common elements that represent EDA's basic approach to the economic adjustment process.

These elements are:

One, response to the community: EDA does not superimpose a formula developed in Washington, but rather, consults with the community and provides the help needed for it to plan and carry out its own economic adjustment program.

Two, involvement with the private sector: EDA has always recognized the critical fact that it is the private sector which, in the final analysis, creates and provides employment. EDA's job is to provide the technical assistance, bricks and mortar, or business finance assistance necessary to spur private investment.

Three, spinoff: In the case of Georgia, there were several. First, and most important, is the direct effect of a plant staying in business. In addition, further private investment was created, providing more jobs, a larger tax base, and more business for others. There was also the involvement of the banking community in saving the area's economic base. Finally, there was the establishment of a revolving fund, controlled at the local level, for future development purposes.

This committee is looking at, among other things, the effects conglomerate decisions may have on local communities and economies. I cannot, from EDA's experience, speak to the issue of mergers, but I can make a few comments on the matter of divestitures.

It happens that EDA support for employee stock ownership plans has been in cases resulting from a corporate decision to close or sell one of its divisions. In each case, the firms affected were profitable and had a fairly long history of successful operation—in one case, over 100 years.

In every case, closure would have been a severe blow to the economic base of the community. The corporate decisions to divest were not, to our knowledge, made lightly or without sufficient reason within a business frame of reference.

In each case where EDA has intervened at the request of local leaders, the venture has been successful in retaining the threatened employment base and providing good prospects for continuous operation.

And, I believe this is because those at the community level most immediately affected—workers, management, the private sector—have been able to marshal their energies and resources in a cooperative effort to meet the economic threat of dislocation.

A final comment on EDA's general views vis-a-vis ESOT's. EDA views ESOT's as one of a variety of ownership arrangements to be evaluated on its merits in terms of permanent job creation or retention potential on a case-by-case basis.

In evaluating business assistance proposals, several factors are taken into consideration:

First, basic program eligibility criteria;

Second, the likelihood of long-term viability, based upon financial, market, and management data;

Third, job creation or retention potential; and,

Fourth, cost-effectiveness of the public investment.

When EDA assisted ESOT's in the past, it was because an ESOT proposal was put forward that represented an appropriate and best response to a particular problem.

The ESOT's that EDA has assisted were all formed in response to threatened closures of what our analysts concluded were basically viable enterprises. All are now prospering.

Mr. Chairman, this concludes my prepared statement, I will be happy to respond to any questions.

Mr. BEDELL. Thank you very much.

[Mr. Hall's prepared statement follows:]

PREPARED STATEMENT OF ROBERT T. HALL, ASSISTANT SECRETARY OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION

Mr. Chairman, I am pleased to have the opportunity to testify before the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business. As you noted in your invitation, the Economic Development Administration (EDA) does play an important role in assisting communities to recover from economic dislocations such as the closure of a major employer. In my testimony I would like to share with the Subcommittee some of EDA's experiences in assisting communities impacted by economic dislocations, particularly those resulting from the divestiture of a company by a conglomerate corporation.

The primary mission of the Economic Development Administration is to address the problems of chronic high unemployment and low per capita income in economically distressed urban and rural areas of the country. EDA carries out its mission by making investments aimed at stimulating the creation of permanent, private sector jobs in such areas. More specifically, EDA provides grant funds to help develop public and private institutional capacities, to provide technical assistance and economic information, to build public facilities and to rehabilitate older, useful structures, to acquire land, and to provide, either directly or through Federal guarantees, investment capital for private enterprise.

In 1974, Congress recognized that preventing economic dislocations is as much a part of effective public sector economic development action as initiatives to deal with long-term structural economic problems. As a result, Congress gave EDA, through the Title IX amendment to Public Works and Economic Development Act (PWEDA) of 1965, the basic tools for coping with actual or threatened economic dislocations, whatever the cause. In response to that amendment, the Office of Special Adjustment Assistance was set up in EDA.

Our special responsibilities include responding to sudden and severe economic dislocations for areas either impacted, or threatened by events such as a plant closing or a sharp cutback in production and employment. We also respond to military base closings, or the establishment of new defense installations, which can spawn a boomtown syndrome that can have deep and abiding impact upon a community.

Title IX has the advantage of giving EDA great flexibility in being able to respond to actual or threatened dislocations. The Title IX program is intended to help local areas, urban or rural, develop and implement economic adjustment plans. We try to anticipate and solve serious adjustment problems before they can undermine local economies. If we cannot, it is then our job to assist the affected community to reestablish employment opportunities and economic stability as soon after the dislocation as possible.

In a sense, the economic adjustment program authorized by Title IX presents a concentrated, speeded-up view of economic development, as seen and practiced by EDA.

A good example is the case of a firm in Georgia which normally employed about 900 workers. Located in one of the poorest counties in the state, its ability to provide work and income to the area is tremendously important. The parent firm, a large conglomerate, tried to sell the subsidiary. When it could not locate a buyer, it announced that it would close the facility and liquidate the assets. This decision would have had serious repercussions to the local economy, not to mention the families dependent upon incomes generated by the business.

Upon the invitation of the community, working through an EDA-supported economic development district, aid was sought from EDA to prevent closure. In this case, the employees requested EDA assistance to purchase the firm themselves.

The means by which this was accomplished is not as important as the side effects. What EDA did through its Title IX program was to grant sufficient funds to the economic development district, which in turn lent the money to the newly-formed Employee Stock Ownership Trust (ESOT). This action succeeded in leveraging local monies and loans from local banks; provided the means to purchase and reorganize; and also to set up a revolving loan fund which, because of repayments, could be used over and over for other development projects in the area. Not only has the original adjustment venture been successful (the firm has since added to its 900-member payroll) but at least four other firms have been saved or expanded, creating new activity and jobs.

I could recite several other examples in EDA's experience, some similar with regard to the techniques used, others quite different. But there are common elements that represent EDA's basic approach to the economic adjustment process. These elements are:

Response to the community.—EDA does not superimpose a formula developed in Washington, but rather, consults with the community and provides the help needed for it to plan and carry out its own economic adjustment program.

Involvement with the private sector.—EDA has always recognized the critical fact that it is the private sector which in the final analysis creates and provides employment. EDA's job is to provide the technical assistance, bricks and mortar, or business finance assistance necessary to spur private investment.

Spinoff.—In the case of Georgia, there were several. First, and most important, is the direct effect of a plant staying in business. In addition, further private investment was created, providing more jobs, a larger tax base, and more business for others. Third was the involvement of the banking community in saving the area's economic base. Finally, there was the establishment of a revolving fund, controlled at the local level, for future development purposes.

This committee is looking at, among other things, the effects conglomerate decisions may have on local communities and economies. I cannot, from EDA's experience, speak to the issue of mergers, but I can make a few comments on the matter of divestitures. It happens that EDA support for Employee Stock Ownership Plans were cases resulting from a corporate decision to close or sell one of its divisions. In each case, the firms affected were profitable and had a fairly long history of successful operation—in one case, over a hundred years.

In every case, closure would have been a severe blow to the economic base of the community. The corporate decisions to divest were not, to our knowledge, made lightly or without sufficient reason within a business frame of reference.

In each case where EDA has intervened at the request of local leaders, the venture has been successful in retaining the threatened employment base and providing good prospects for continuous operation. And I believe this is because those at the community level most immediately affected—workers, management, the private sector—have been able to marshal their energies and resources in a cooperative effort to meet the economic threat of dislocation.

A final comment on EDA's general views vis-a-vis ESOTs. EDA views ESOTs as one of a variety of ownership arrangements to be evaluated on its merits in terms of permanent job creation or retention potential on a case-by-case basis. In evaluating business assistance proposals several factors are taken into consideration:

Basic program eligibility criteria;

The likelihood of long-term viability, based upon financial, market and management data;

Job creation or retention potential; and

Cost-effectiveness of the public investment.

When EDA assisted ESOTs in the past, it was because an ESOT proposal was put forward that represented an appropriate and best response to a particular problem. The ESOTs that EDA has assisted were all formed in response to threatened closures of what our analysts concluded were basically viable enterprises. All are now prospering.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to questions.

Mr. BEDELL. Mr. Williams, do you have any questions?

Mr. WILLIAMS of Ohio. Thank you, Mr. Chairman.

Mr. Hall, you have given three missions that EDA is supposed to accomplish as we approach solutions to high-impacted areas with plant closings: Provide help, private sector encouragement, and assist a spinoff to stay in business and provide long-term employment.

The problem I am having, and I think most people are having in the district I represent, is that EDA has set aside $225 million for steel-related projects. There is some irony here that confuses me and I think most of the other people that are trying to answer the problems of the Mahoning Valley.

The irony simply is that we have $225 million set aside; yet United States Steel has decided to close within a week or so, and J. & L. decided prior to that by 2 years. It is confusing to me how EDA is going to accomplish the aim of all of us to provide employment.

If we are going to count on the private sector to do it, obviously the best ones to take part in the $225 million loan guarantee program would have been J. & L. or United States Steel. They could have used it to update their facilities.

They were probably the best people who could have done it. They chose not to. They simply wrote the Mahoning Valley off. I think all of us realize that. They wrote it off as a marginal area in their overall picture.

Therefore, I think the last 2 years since you originally set aside the money have shown that nothing is going to happen if we continue to count on the private sector.

Unless I heard you wrong, ESOT's have worked. You have somewhat of a good track record of employee ownership programs working.

The question I want to ask you is this. What is going to happen in the Mahoning Valley. The $225 million is a nice sign and a nice signal that Washington responded to the problem. But, in fact, it will never be used based on the position that I think EDA has taken, and that the administration has taken, in trying to solve this problem.

Mr. HALL. Congressman, first let me attempt to clear up the confusion about the $225 million. There is a $100 million set aside under the special steel loan guaranty program and that is a commitment. That $100 million is available and, indeed, provisions are made in EDA's reauthorization bill for that authority to continue under the new proposed legislation.

The other $125 million which I announced before the Senate steel caucus some months ago is not directly related to, and is not a part of, the steel loan guaranty program. That $125 million, contingent on the passage of new authorization legislation, is for diversification of the economy of the Youngstown area.

So, it is not appropriate to lump the $125 million with the $100 million and say it is $225 million for the steel industry or related projects.

Second, I just want to underscore my disagreement with your statement that nothing is going to happen because the private sector is not interested.

Mr. WILLIAMS of Ohio. I am talking about the steel industry. I am talking about the private sector so far as the steel industry is concerned. Obviously it is not interested.

Mr. HALL. We have had discussions with steel firms. Indeed, there are some loans, perhaps not related to the two firms you mentioned, being considered in the Youngstown area for steel facilities under our regular loan program.

I would just comment in terms of your reference to the ESOT's. Yes; our ESOT's have worked, based on indepth analysis to determine the viability of each proposal.

But in the final analysis, it is the private sector that is going to have to provide the impetus for new job development and the diversification of the Youngstown economy. The best we, as a Federal agency, can do is make funds available. The banks are going to have to put the money up. The private sector, employers and entrepreneurs, are going to have to make the decisions to make those investments and loans.

A case in point is the project that you are familiar with, the Commuter Aircraft Corp., where the agency has provided a letter of intent for a guaranteed loan of up to $30 million to create many jobs in that endeavor.

This is a project that you were actively involved with, and one that we think is an example of the kind of thing that we should be ready to do in the Youngstown area.

Mr. **Williams** of Ohio. The $100 million that you were talking about that was set aside, I did realize the breakdown.

I would like to have your answer as to what steel project we can build for $100 million to answer an employment problem in the Mahoning Valley?

In the 14 months that I have been here, people have talked with me about the steel-related project, and in talking about the Mahoning Valley, they have some of the difficulties we have because of our weather; the so-called movement to the shores of water to build the future steel industry, et cetera and in my opinion, $100 million will not even begin to touch the viable steel project.

Maybe it will build a coke facility. I have supported a coke facility, but that in itself is a little confusing also. I do not know who we are going to sell coke to if we have no steel industry there.

The point is this. While $100 million is a nice sum, it has been there for over 2 years and nothing has happened, either through your efforts, my efforts, or the former Congressman's efforts, to solve the problem.

I do not see that changing. I think we have lost one of the very valuable tools we have had in time alone. The 2-year period is past. The Campbell facility has deteriorated now probably beyond any hope of ever reopening.

We have an announcement by United States Steel concerning two other facilities which appear to have been closed. As you probably know, there is a lawsuit in court now trying to postpone their closing date announcement.

This would help us to solve some of the problems and provide us some time to find a purchaser.

Now the other fact that has come into the case is that United States Steel said they will not sell to a competitor. It is an almost impossible situation.

It is mind-boggling to me how we are going to solve the problem. I think your agency has taken the blame for it because you turned down the Coalition. The charges were made against you at a hearing that you said you were going to consider ESOT's and you were concerned about the area, but turned them down.

How are you, as an agency, going to solve the problem? How are you going to assist when you have United States Steel that will not sell the property and were not interested in the Coalition's activities to the extent of potential funding?

I believe you have to answer those charges that they were misled. They said you misled them, the administration misled them. How are you going to solve the problem?

The other thing I want to talk about is Wisconsin Steel.

Mr. **Hall**. There are several implicit and explicit questions in your comments. Let me try to deal with these as I can recall them.

First, in terms of your opening comment about the $100 million commitment for the Mahoning Valley, clearly our view is that no single project is going to deal with the broad and deep structural economic difficulties that the Valley faces. That is why we are working on a broad range of activities to assist the local community and its employers in trying to diversify and revitalize that economy.

That, again, is one reason for the commitment of the $125 million in loans and loan guarantees to aid in diversification. In addition, as you are aware, we have stationed a person in the Youngstown area to help coordinate the Agency's efforts.

In terms of the $100 million, we realize that you cannot buy a major complex steel mill for $100 million. The $100 million would be used as a catalyst to bring in other investments.

I should note that the $100 million set-aside for Youngstown is almost 20 percent of the total funds made available nationally for the steel loan guaranty program which amounted to $550 million overall.

I would like to come to the point in terms of the Ecumenical Coalition's proposal which was one to which we gave very serious consideration. On the basis of our analysis, this project was not viable nor could it be restructured into a viable ESOT or other similar activity.

Men of good will can differ on judgments such as that. But I think our record stands clear in terms of our working with the Ecumenical Coalition over many months in an attempt to pull together a viable project.

If it would please the committee, I am aware of certain allegations and charges that have been made regarding the Agency's handling of this particular proposal, and I would like to submit for the record the Agency's position on the processing as it relates to the Ecumenical Coalition proposal.

Mr. **Bedell**. Thank you. We would be glad to have that.

Without objection, so ordered.

[See Appendix U and Appendix V.]

Mr. **Bedell**. You indicated you gave serious consideration to the proposal of the Ecumenical Coalition in this matter.

Mr. **Hall**. Yes, sir.

Mr. **Bedell**. The Freedom of Information Act information from EDA files obtained by the Ecumenical Coalition states as follows:

> NCEA is less important than the other organizations mentioned. It will recommend the unfeasible solution of spending vast sums of Federal dollars to reopen a facility which will never again regain its market share, let alone be self-sustaining.

This was written by EDA officials before the study was ever made. That would raise a lot of questions in people's minds, first of all, as to why we would spend $300,000 for a HUD study.

Is there something I do not understand about the statement I just read? Is it accurate? [See Appendix W.]

Mr. **Hall**. Let me elaborate and try to put it in perspective. Certainly we are capable of making an in-house, internal analysis of even broad-brushed proposals. We have some understanding of the circumstances.

In our initial preliminary analysis, we raised some serious questions about the proposal. However, the fact is that the proposal, as it was initially proposed to us, looked very weak. We made a preliminary judgment that this, indeed, was going to be a difficult proposal to put into any shape so that it could possibly be financed.

The decision was made, then, to provide some technical assistance. Indeed, the HUD TA grant you talked about, which was then in effect, was used to try to further develop the study for the applicants.

Mr. **Bedell.** Is it correct that at this very same time you are working with Wheeling-Pittsburgh in regard to a loan for their facility?

Mr. **Hall.** Yes, sir. We were working, as part of the mandate of the steel loan guaranty program, on that. We worked with several applicants of which Wheeling-Pitt was one.

Mr. **Bedell.** We are trying to learn what we can. From these records it would look like your organization had decided that the Ecumenical Coalition proposal made no sense.

Yet, there was a HUD grant of $300,000 to investigate and look into a proposal on which a determination had already been made. That makes no sense.

Was that communicated to HUD? Was that communicated to the people who were so involved and whose hopes were elevated because of the $300,000 grant?

What would be wrong is if the decision had already been made to spend $300,000 on a study which you had already decided was not worth investigating——

Mr. **Hall.** I repeat that the decision was not made. The initial proposal was some *x* pages of an outline describing how they would like to go about resurrecting the Campbell Works facility.

Our preliminary review of that outline gave us very serious doubts. Subseqent to that preliminary judgment, a decision was made to provide some resources to this group to see if they could develop a proposal and make their case.

Then, on the basis of the HUD-financed work and other work, we made a concerted in-depth analysis of the full-blown proposal and came to the conclusion that indeed it was not viable.

Mr. **Bedell.** Is this statement correct? It's from the memo obtained by the Freedom of Information Act which was written before the $300,000 was spent.

It says:

> It will recommend the unfeasible solution of spending vast sums of Federal dollars to reopen the facility which will never regain its market share, let alone be self-sustaining.

Is that correct?

Mr. **Hall.** I assume you are reading what was written. Again, I repeat, from preliminary analysis, we had serious concerns about the proposal. We are not without some capacity to make some judgments in very preliminary oral or written form on proposals that are raised with us.

Mr. **Bedell.** Were these concerns communicated to the Coalition so they realized you felt it did not make any sense?

Mr. **Hall.** We raised and expressed our concerns with the Coalition from the beginning. We raised and expressed our concerns with the parties at HUD about the funding of the proposal.

We had a meeting involving the Coalition. All the local leadership in Youngstown, representatives of HUD, and representatives of EDA met in my conference room. We went over the initial proposal. Subsequent to that, the HUD grant was funded.

Mr. **Bedell**. In the testimony we had in an earlier hearing, the Ecumenical Coalition testified as follows:

> I have in my file, Mr. Chairman, just a three-quarter inch sample. Compare, if you will, the manner in which EDA was partner to Wheeling-Pittsburgh in that company's applications with loan guarantees and the ultimate perfection of their application.
>
> Compare this with the fact that Youngstown received no memoranda, no correspondence, no opportunity to respond to critical commentary in its application for loan guarantees.

Do you believe that statement he made is incorrect?

Mr. **Hall**. Yes, sir.

Mr. **Bedell**. I thank the gentleman for yielding.

Mr. **Williams** of Ohio. Mr. Hall, at the same time this was all happening, a firm known as Wisconsin Steel was beginning to develop.

I would like you, if you could, to comment on the criteria used to develop that loan.

Mr. **Hall**. The basic criteria for that loan guaranty and any other steel loan guaranty, and indeed any other loan guaranty that the Agency supports, obviously go to an analysis of the financial viability of the package. We ask if there is a reasonable expectation that the Federal support can be repaid.

From that flows other criteria in terms of the management capability of the entity and its operation, the product quality, competitiveness in the market, thorough marketing studies and their feasibility.

In effect, Congressman, we are concerned with the basic business judgments that would support the use of taxpayer dollars in such a venture.

Mr. **Bedell**. Were you heavily involved in that decision? Did you study the financial statements before the loan was made?

Mr. **Hall**. I am sure you can appreciate that, given the size of the loan guarantees and the importance of them, that I participated very heavily in the consideration of them. Obviously I did not personally engage in extensive financial analysis or other kinds of technical matters.

Mr. **Bedell**. But you did go over their financial statements?

Mr. **Hall**. I did not go over financial statements, per se. I went over the documents prepared by my staff on the feasibility of the project.

Mr. **Bedell**. I presume you were well aware of the sales and net worth of the company that purchased this division from International Harvester.

Mr. **Hall**. I have some knowledge, yes, sir.

Mr. **Williams** of Ohio. Following that line, would you agree that the company was a good investment? Or the firm who bought it from International Harvester, which was Envirodyne? I am looking at them and it appears to me they were a paper organization.

Mr. **Hall**. It was our considered judgment that this was a viable project in terms of the objective of the program tc try to preserve jobs and maintain competition in the steel industry.

The facility in question could be turned into a viable operation and made competitive.

Mr. WILLIAMS of Ohio. Even though they lost $17 million the prior year?

Mr. HALL. The company was in financial difficulties, yes. Indeed, that is one of the reasons we assist firms.

Mr. BEDELL. I think, for the record, we need to clarify what my understanding of the situation is. You can correct me if I am wrong.

My understanding is that International Harvester owned a steel mill; is that correct?

Mr. HALL. Yes.

Mr. BEDELL. International Harvester owned the steel mill. The steel mill was then sold to a small company, which was very much smaller than International Harvester, on which International Harvester took sizable notes; is that correct?

Mr. HALL. That is my understanding; yes.

Mr. BEDELL. The small steel company had very, very limited capital. It jumped in asset size from $15 million in 1976 to $158 million in 1977 with the same capital they had previously and with a situation that was marginally profitable over the past 4 years.

In fact, over the past 4 years, it had not generally shown a profit. Does that jibe with what you have?

Mr. HALL. That jibes with my recollections.

Mr. BEDELL. Since you are precluded from making money available to firms such as International Harvester, which would have other sources of capital available, you were then in a position to make the loan to Envirodyne so that they could, indeed, pay off the International Harvester loan. That is the understanding we have.

It just boggles my mind if I understand things correctly. Is there something we do not understand?

Mr. HALL. I do not believe the facts are correct as you state them.

Mr. BEDELL. Would you correct what I am wrong about?

Mr. HAROLD W. WILLIAMS. The money was not loaned to Wisconsin Steel for them to pay off International Harvester. As a matter of fact, one of the conditions of our financial assistance was for considerable additional investment by International Harvester in the project.

Mr. BEDELL. Did not International Harvester make that additional initial investment?

Mr. HAROLD W. WILLIAMS. I am under that impression. Yes; they have guaranteed loans and credit for them.

Mr. BEDELL. International Harvester has made additional——

Mr. HAROLD W. WILLIAMS. That is correct. International Harvester also guaranteed them a market for the steel and also guaranteed them some supplies. So, International Harvester was not making money on this. International Harvester was coming along with us on this deal.

Mr. BEDELL. To whom is Envirodyne selling their steel? Do you know?

Mr. HALL. Part of it is going to International Harvester.

Mr. **Bedell.** On the loan that you make to them, you are required to get a 10-percent participation, as I understand it. Who provided that 10 percent participation?

Mr. **Hall.** The 10 percent nonguaranteed portion was assumed by Harvester.

Mr. **Bedell.** Does that not shock you?

If we understand it correctly, International Harvester sold its business to this little tiny company, Envirodyne. In order to sell it, they assumed a $50 million loan indebtedness, an indebtedness from Envirodyne.

If they went broke, International Harvester would lose their $50 million. So, if the loan could be made to Envirodyne, and if they could be kept in operation, International Harvester would not lose that $50 million.

But in order for you to make a loan, you must have a lending institution that will put up the 10-percent-nonguaranteed portion of the loan.

Did you try to go to banks or other institutions to get that 10 percent participation?

Mr. **Hall.** I would like to ask Mr. Levin to join us at the table.

Mr. **Bedell.** Great. We may not understand the whole thing. It boggles my mind. I might not understand it correctly.

Mr. **Levin.** My name is Edward Levin. I am the Chief Counsel of EDA.

As such, I participated in the final approval and closing of the loan guaranty assistance to Wisconsin Steel.

There were, in fact, two loans of which EDA guaranteed 90 percent. One was a working capital loan and one a fixed asset loan. In each case there were other financial institutions which made the actual loans.

In the case of the $15 million working capital loan, the Chase Manhattan Bank was the lending institution. In the case of the $75 million fixed asset loan, to modernize the facility and to provide pollution control equipment, insurance companies were the lenders. Connecticut General Life Insurance was the lead lender. There were five additional insurance companies that were also lenders.

The loans were guaranteed 90 percent by EDA. The lenders insisted that, given the risks of these loans, the 10-percent portion that was not guaranteed by EDA, be guaranteed by International Harvester.

It is that 10-percent assumption of a guarantee that the Assistant Secretary referred to.

Mr. **Bedell.** That is the thing that is so difficult for me to understand. At least in my experience, which is very limited, the reason for the 90-percent guarantee is to see that the lenders feel that the loan makes enough sense so that they will assume some of the liability.

Apparently the lenders told you on this loan they were not willing to assume that 10 percent of the liability. So, the person who is going to benefit from the loan, namely, International Harvester, said they would go ahead and assume that 10 percent because they were better off to do that than to lose their $50 million.

So, what we really did was that we bypassed the intent of the legislative process, which is to insure the lending institutions will not make bad loans. That is the reason we do not guarantee 100 percent of the loan and only guarantee 90 percent so that the lending institutions will have some exposure.

I cannot imagine your agreeing to such a proposal and removing what would seem to be a necessary element to assure that the loans were properly screened.

Indeed, if I understand it correctly, Envirodyne is in financial trouble and is losing money.

Why is it that you pursued a different direction than what was the intent and purpose of Congress?

Mr. **Williams** of Ohio. The point I think I am trying to make and the chairman is trying to make, is that there were $4 million worth of funds set aside in the Mahoning Valley by the people of the Mahoning Valley in the so-called Save Our Valley accounts.

It was $4 million of a $100 million proposal with nearly half of the 10 percent that the people had committed but apparently, according to some of the charges, they were getting no cooperation at all, it seems.

Mr. **Hall**. We believe the Coalition proposal got a full and fair hearing. There were other difficulties with the Coalition proposal that went beyond the point you are raising in terms of the $4 million.

Mr. **Williams** of Ohio. I think the gentleman should answer the chairman's question, but just to comment on what you have said, let me say this.

I am sure there were many considerations. The thing that confuses me is this. Did they really get the cooperation that they should have from your agency? It appears you are more than willing to give United States Steel, International Harvester, and Envirodyne—you found a way to work those things out with them.

Mr. **Hall**. We have submitted for the record our position on negotiations with the Coalition. We will stand on our record.

In terms of the Wisconsin project, Mr. Chairman, it indeed was a very difficult project to put together. There were up to 4,000 jobs in the facility at stake. We attempted to work out the best possible package we could to see if we could maintain that facility as a viable operation and to maintain those jobs in Chicago in the particular area of the steel mill.

Mr. **Bedell**. Suppose I am International Harvester and I wanted to spinoff a failing subsidiary to a little company which could qualify for EDA assistance. I would sell this subsidiary to this little company and they would then owe me $50 million dollars. The small company could then apply for an EDA loan guaranty for 90 percent of the loan. But, because EDA could not find any banks willing to take the remaining 10 percent, EDA says to me:

> Well, since your are into it that heavy, you just go ahead and guarantee the 10 percent of the loan so we can go ahead and make it, even though the banks will not approve it. We will make the loan which will, give you better chance of not losing your $50 million.

Is that the way EDA operates? Is that what we have here? If it is, I do not think my taxpayers think that is the way things ought to work.

Mr. HALL. Mr. Chairman, it is not customary, but in certain circumstances in attempting to work something out we make what in our judgment are the best possible packages.

Mr. WILLIAMS of Ohio. I think the criteria you used, the 4,000 jobs and keeping the facility moving; there were 5,000 more jobs involved at Campbell. I am hoping the same interest is there.

You say there were other problems with the Coalition's proposal. I am aware of some of those. I think you were concerned about management teams.

But the point I think we are trying to make with this discussion is this. The charge has been made they got no cooperation from EDA while other people were getting cooperation.

I think from what we have seen here, that is a pretty substantial charge. You seem to work closely with other companies because of the reason of *x* amount of jobs in the community. Yet, the Coalition did not get that cooperation. Maybe there were other reasons that you would like to tell us about.

Mr. HALL. I think there is a difference again in that it was a facility that had been closed and the proposal had serious flaws in it, as opposed to Wisconsin Steel where you had an operating steel mill with 4,000 existing jobs and a package being put together that involved the companies.

It was our judgment at the time of the Wisconsin Steel proposal that a viable package could be put together. We worked on it. It was our judgment at the time that the Coalition proposal, after extensive study and grants to assist in the development of the proposal, was not going to be viable.

Mr. KARRAS. I am not so sure, Congressman Williams, that it is fair to compare our investment in Wisconsin Steel with the denial of the Ecumenical Coalition proposal.

Mr. WILLIAMS of Ohio. I am not trying to compare that. I simply am trying to say that it appears you cooperated and worked with these people very closely to overcome some major hurdles, but that the Coalition claims they got no cooperation.

Mr. KARRAS. I understand. I would like to speak to that because the material which the Assistant Secretary is supplying for the record, I think, details quite clearly that one of the threshold questions went to the amount of money that the Agency had available for a viable steel project in Youngstown. That was $100 million.

The record is clear. We have evidence in terms of letters from Mr. Watson in the White House that that was the amount of money that was available, even when there was a misinterpretation regarding the $100 million which was erroneously reported in the Washington Post.

Once that misinterpretation occurred, then the Agency found it necessary to clarify that situation.

Frankly, there was a manifestation of some arrogance on the part of the proponents regarding the amount of money available for Youngstown. We only had $550 million for the entire program and had already targetted $365 million on other pending projects.

The amount of money available for Youngstown was $100 million. Then the proposal from the Coalition came in for a guarantee of $245 million. In effect, it said to the Agency, that was their proposal.

So, there is a threshold question. Leave aside the issues of management. Leave aside the issues of equity participation. Leave aside the issue of whether indeed under a worker ownership arrangement, productivity can increase by 21 percent. Leave aside other sorts of issues as to viability. Leave aside those issues which were addressed fully in our review.

The funding level issue was by itself a no-go kind of issue.

Mr. Williams of Ohio. Maybe I should go back to Youngstown and form a paper company run by United States Steel. I think you will fund us.

Mr. Karras. I cannot respond to that.

Mr. Bedell. You understand his question, though. It appears that is exactly what happened with International Harvester.

Why do you think the Government loans are only 90 percent guaranteed instead of 100 percent? Why do you think we legislated that?

Mr. Hall. I think the purpose, as I indicated earlier, was to give the lenders some liability.

Mr. Bedell. And you removed that in the case of Wisconsin Steel with regard to International Harvester. Is that correct?

Mr. Levin. Mr. Chairman, the concern is that there be a private sector interest, both in terms of——

Mr. Bedell. The concern with the Congress, so far as I am concerned, when we passed that legislation was very clear. The purpose was to insure that the lending institutions would have some exposure so that they will not be making bad loans. If you think that is not the purpose, then we need to get it straight.

It is very clear that what you did in this case was to completely bypass that and remove all the exposures. So, there was no reason in the world for lending institutions not to make the loan because the Government was going to guarantee 90 percent of it and International Harvester was going to guarantee the other 10 percent. That, I think, is a very, very serious concern.

If your organization is acting contrary to what the wishes of Congress were when we passed this legislation, then it is tremendously important, especially when it looks like this loan is going to go down. It was a loan to a company that in 1974 made $825,000, in 1975 lost $294,000, and in 1976 made a profit of $228,000. But in August 1977 after Wisconsin Steel merged with Envirodyne it lost $1.24 million, and in 1978 lost $17 million. I think this is a serious concern.

What do you do if you are sitting here in Government trying to see that there is some control over how money is spent by the Government? Then we have your organization come and bypass that control in order to throw more money out there. What do we have to do legislatively to say that we want some exposure by the people who lend the money?

There is just no question in my mind that was the intent. I think Mr. Hall understands that was the intent. Apparently the legal counsel does not think that was the intent.

Mr. **Levin**. Mr. Chairman, of course, there was no intent on the part of the Agency to bypass any intent of Congress in this matter or in any matter.

Mr. **Bedell**. Did you do it without intending to? Why did you do it?

Mr. **Levin**. The issue in a loan of this size goes to the availability of financial institutions which have sufficient funds to invest. In this case, with a loan of this size, it is most understandable that insurance companies rather than banks are the ones that would have this amount of money to invest and to invest at the favorable interest rates that were involved in this transaction.

The insurance companies were the long-term, fixed-asset lenders in the Wisconsin Steel matter.

Mr. **Bedell**. Did they put up 10 percent?

Mr. **Levin**. The insurance companies loaned the full $75 million with the 90-percent guarantee from EDA and the 10-percent-effective guarantee from International Harvester.

Mr. **Bedell**. I do not think we are communicating. I am telling you the intent of the Congress was that the lending institution that loaned the money would lose something if the project was unsuccessful.

You completely bypassed that by not having them risk any exposure. Maybe it is because the law is improperly written. We would be in a heck of a mess if that is the way government is going to operate. We can't allow somebody who is in debt for $50 million to put up 10 percent of a loan and have the Government put up all the rest.

The lending institution has nothing to lose. The people who are already in debt have nothing to lose. There is no control whatever on that loan.

Apparently you did not feel that was the intent of the Congress. Is that where we have our problem?

Mr. **Levin**. Mr. Chairman, I do not think there was any misunderstanding as to the intent of Congress.

Mr. **Bedell**. Then what do you think it was?

Mr. **Levin**. The intent of Congress, as we understand it, is to assure that a private institution, the lender in most cases, but certainly another private institution where the lender risk is not possible, risks a full 10 percent.

It was to achieve that purpose that we approved the International Harvester guarantee in this case.

What distinguishes this case from any ordinary case is principally the size of the loan and the difficulty of fulfilling a lender risk at the same time as achieving the other purposes of the loan, including the favorable interest rate from this kind of financial institution.

In practice, we are informed and believe that an insurance company is just not prepared to assume the kind of lender risk that another kind of financial institution, such as a bank, would ordinarily be prepared to assume.

Mr. **Williams** of Ohio. You would like that better than an ESOT? You like what you have done better than ESOT's which have proven to have a pretty good record? That is confusing to me.

Mr. **Harold W. Williams**. Congressman, we are talking about two steel companies in completely different situations.

First of all, you are talking about less than $100 million, and $225 million. Trying to compare our attitude——

Mr. **Williams** of Ohio. The problem with the Coalition's proposal simply was the amount of money.

Mr. **Harold W. Williams**. That was the initial problem, and that was why we took the very skeptical attitude about it.

Mr. **Williams** of Ohio. Do you agree that someone in the Administration told them there was $300 million?

Mr. **Harold W. Williams**. Absolutely not; not to my knowledge. I was intimately involved. I was personally involved in correcting any misimpression that the Coalition might have had at any time that there was anything more than $100 million available.

Wisconsin Steel was a smaller amount. In negotiating with the Wisconsin Steel people, we were aware of the fact that it was possible to do. There were 4,000 people actually employed at the time in a functioning organization. They are different situations.

These are not easy calls when you have steelworkers out there pleading to have their jobs saved. They are very difficult calls. We are not above making mistakes, but we try to go at these things with sincerity and honesty.

Mr. **Williams** of Ohio. I am not questioning your sincerity. I know you are personally involved. I compliment you for that.

However, tell me one area in this country that has been hit harder than the Mahoning Valley steel industry.

Mr. **Harold W. Williams**. Johnstown, Pa. has been hit harder than the Mahoning Valley by the steel industry. We have worked with them.

Mr. **Williams** of Ohio. Apparently Chicago was.

Mr. **Harold W. Williams**. Chicago, that particular part of Chicago was coming close to being hit harder.

Mr. **Williams** of Ohio. How do we approach the United States Steel closings, which next month will cause another 6,000 jobs lost with EDA's $225 million set-aside? How do we get into this agency and get a project that will employ 1,000, 2,000, or 5,000 people? How do we do that? Do we put together Wisconsin's proposal? Do we put together an ESOT? How do we do that?

Mr. **Hall**. I would respond this way. I think our commitment to the Youngstown area is well documented. I think anybody should know that in terms of the funds that were made available, set aside and actually allocated in terms of grants, loans, et cetera.

We have stationed a person there.

So far as what can be done in the future in Youngstown, we stand ready to consider any viable project from any source to create economic activity in the Youngstown area.

If a good ESOT were to come along and would prove financially viable, we would be delighted to work with it. But we do not own Campbell Works. We do not own McDonald Works. We are not the people to put the project together. It has to be local leadership. It has to be local private entrepreneurial talent and private resources to bring us a viable project.

If it is within the act, we will give it very serious consideration.

Mr. **Williams** of Ohio. I am very aware that you do not own Campbell Works. But it appears you do own the Wisconsin Steel Works.

Mr. **Bedell**. In that regard, what is the amount of your loan to Envirodyne?

Mr. **Hall**. The Wisconsin Steel loan is $90 million—$75 million in fixed assets and $15 million in working capital.

Mr. **Bedell**. According to my records, they had a net worth of $8 million and they lost $10 million in 1978.

If they indeed go bankrupt, how much do the taxpayers lose and how much does International Harvester lose? Where does their loan stand in priority to the Government's if it goes bankrupt?

Mr. **Hall**. The answer to those questions, obviously, would be determined at that point in time if it were to go bankrupt.

Mr. **Bedell**. Will International Harvester be paid off before the Government, after the Government, or proportional to the Government?

Mr. **Levin**. Proportional and after.

Mr. **Hall**. It is a very complicated loan package. There are many features to it. A specific response to your question would require us to submit an analysis for the record.

Mr. **Bedell**. I am not talking about the 10-percent guarantee. I am talking about the $50 million that International Harvester was owed by Envirodyne for the sale of their Wisconsin Steel division.

Where does that $50 million stand in terms of payment, if there is bankruptcy?

Mr. **Levin**. For almost all the collateral security, Harvester is subordinated to or would be paid at the same time as EDA. For none of the security would Harvester be ahead of EDA.

Mr. **Bedell**. Is most of that $50 million still owing?

Mr. **Levin**. I cannot respond to that, because that goes back to the original deal between Harvester and——

Mr. **Bedell**. I think it is pretty critical. If a large part of the money put in by the Government went to pay off the $50 million, we sure want to know about it. I think you would know it. I am amazed that you would not.

Mr. **Levin**. I cannot speak to what repayments might have been made.

Mr. **Bedell**. Can anybody from your organization?

Mr. **Hall**. With all due respect, Mr. Chairman, I did not realize this was going to be an in-depth hearing on Wisconsin Steel.

Mr. **Bedell**. Our staff advised you it would be.

Mr. **Hall**. I was not apprised that it would be in such depth.

Mr. **Bedell**. Then your staff did not properly advise you, Mr. Hall.

Mr. **Hall**. Very good, sir. I did not know this was the jurisdiction of this subcommittee in terms of the steel programs.

Mr. **Bedell**. Are you questioning our jurisdiction?

Mr. **Hall**. No, sir, I did not realize you were getting into this much depth. I thought I was coming to testify on ESOT's.

Mr. **Bedell**. If I might say so, you had better check with your staff. I was informed by our staff that your staff was told of the concern we have about Wisconsin Steel.

Clearly this was an area we planned to discuss.

Mr. **Hall.** I did not know we were going to get into the details of the package. We will supply the information you request in terms of that $50 million.

[See Appendix X.]

Mr. **Bedell.** It seems to me this is of some concern. If this loan of taxpayer's money was made under these circumstances with International Harvester, the original indebtor who had a $50 million loan coming, and if your people do not know how much, if any, of the $90 million EDA loan was used to pay off the $50 million International Harvester loan, I have to tell you I am very, very shocked.

I would think that would be something foremost in your mind. I think my taxpayers would not be very pleased to know that what we were doing was bailing out International Harvester.

Mr. **Hall.** We are not bailing out International Harvester.

Mr. **Bedell.** You were if a significant part of that loan went to pay off the $50 million that International Harvester had coming from Envirodyne.

Mr. **Harold** W. **Williams.** May I say this? The intent was not to pay off Harvester, but we would have to have an audit to find that out. None of it was supposed to go to pay them off.

Mr. **Bedell.** If that is the case, and you made the loan without knowing whether it was going to pay them off, and only can find out by an audit, then there is a terrible, terrible problem in the way you administer your loans.

Mr. **Levin.** Of the full $90 million loan, $75 million is for fixed assets. Not a penny of that could go to Harvester. All of that would go in trust to build modernized facilities and pollution control.

Of the $15 million working capital, we believe that none of it could go to Harvester, but we would have to confirm that and report to this subcommittee.

Mr. **Bedell.** There are no requirements on the loan.

Mr. **Levin.** Yes; it was to meet working capital obligations and not debt obligations to Harvester. That is, no part of the working capital was for the purpose of paying Harvester.

Mr. **Bedell.** Would they be violating the loan if they took some of that money and paid Harvester off on that loan?

Mr. **Levin.** It would be in terms of a major debt payment to Harvester. I could not speak to any small payments.

Mr. **Williams** of Ohio. Did this proposal require a lot of time? Apparently it did.

Mr. **Levin.** Over an extended period of time.

Mr. **Williams** of Ohio. This was the same time that the Coalition had their proposal in and you had already determined, according to memos that we have, that that was not a good project from the very beginning, or a month or two before.

The thing that is bothering me again is this; I keep pointing it out. It appears you found every way possible to fund the Envirodyne project. It was probably somewhat questionable.

Yet, already in-house you had determined that the Coalition's proposal had some serious problems, but not enough to encourage HUD to fund $300,000 to try to firm up some areas of concern that your agency had.

That is confusing to me. I think that is confusing. That is really one of the purposes of the hearing, to find out how your agency deals with applications coming in.

Can you respond to that? Was there any effort made to try to remove some of the very apparently small problems compared to Wisconsin Steel? They claim you would not even talk with them. You have denied that accusation. We will accept your response to that.

But I think it is apparent that in this one every effort was made.

Mr. **Hall.** Let me come back to the statement that the chairman read so far as that early memo is concerned. I will have to check the timing of that. I do not have that memo in front of me, sir, or the date. I would like to check.

I would like to suggest this. When the initial package came in from a consultant regarding the Ecumenical Coalition proposal, one of the proposed items that they wanted the Federal Government to do, was, in effect, have the Federal Government commit to the purchase of x tons and y dollars of steel.

I would suggest it did not take much analysis on our part to draw the conclusion that this was not going to be a viable or feasible piece of public policy in terms of requiring the Federal Government to commit to buying steel.

On the basis of that, we made a preliminary analysis of the proposal as it initially came in from a consultant. It was very loose. Therefore, we said:

> OK, they are not steelmakers, they are not proposal makers. We will provide the financial resources for them to go in and do an in-depth analysis, including market studies, financial feasibility, et cetera.

So, the Federal Government extended itself and provided $300,000 for the Coalition to come in with a complete package. When the complete package came in and was reviewed, it was determined that the project was not viable.

Mr. **Williams** of Ohio. But at the same time you had one over here that apparently had just as big a concern, or maybe larger concerns, in terms of financing, that was proceeding right on down the line to eventual funding.

That is what bothers me.

Mr. **Harold W. Williams.** If this hearing draws any inference that this agency gave more attention to Wisconsin Steel than to Youngstown Steel, it would be incorrect.

We gave a great deal of time and attention of high-level people to the Youngstown project and the Ecumenical Coalition. I would say that in the amount of agency time, as much time was spent on that as was spent on Wisconsin Steel.

We are still talking now about a proposal that came in that was basically ineligible because they wanted too much money. Yet, the Federal Government gave them $300,000 to develop the project. We did not give that money to Wisconsin Steel. That money was given to the Ecumenical Coalition. We worked with them. We set up meetings with them in the White House. We had meetings with them in our offices.

At no time were they ever denied any opportunity to come to us and get advice and guidance. I repeat: Any inference that this hearing would draw that we were dilatory in our attempts to work with the Ecumenical Coalition would be a false inference.

Mr. **Williams** of Ohio. Obviously, that charge was made by some testimony that we received earlier. We are pursuing that and trying to get clarification.

Mr. **Bedell**. Mr. Quayle?

Mr. **Quayle**. Thank you, Mr. Chairman.

I do have a couple of questions and then you will have to excuse me because we have the security assistance bill in Foreign Affairs.

I do not want to mitigate the concern of my colleague, and the chairman pointed it out by somewhat changing the subject. I think their concern is a legitimate one. I think it is generally shared.

My question is this: What kind of data do you use? Or, what kind of effort is being made to target some loans to small business? Is there a special consideration given to small businesses in general? If so, how do you go about this? If not, why not?

Mr. **Hall**. There is, as you know, a Small Business Administration. Historically we have, in effect, divvied up the turf, if you will.

The Small Business Administration primarily handles loans of $500,000 and under. We handle the larger loans. This was appropriate in prior years because the funding levels of EDA's business loan programs were relatively modest: $200 million or $300 million a year for the agency as a whole. That does not mean, however, that we have not made a significant number of loans to small business.

There is always the difficulty of definition of small business. I will ask Mr. Karras, who has the data in front of him, to show that the agency does have a significant track record, with, indeed, a great majority of loans going to firms less than $5 million in assets.

Mr. **Bedell**. In fact, it goes quite to the contrary. You have a special steel program, if I understand correctly.

Mr. **Hall**. That is correct.

Mr. **Bedell**. As I understand it, it is only for integrated steel companies and would apply only to the top 20 companies. Therefore, even midsize steel companies are excluded from consideration of loans, no matter how many jobs they might provide.

An exception may be made in regard to the proposed coking facility in Youngstown.

Is that correct?

Mr. **Hall**. Yes; but I think the chairman has to understand the special steel program is exactly that. It is something separate and different from our regular ongoing business loan program. It was specifically set up as a response to the Solomon report, which describes the need of many firms, unable to acquire capital in the regular market, to secure funds from our organization to meet pollution requirements and so forth.

In terms of the guidelines on which we testified before the appropriations and authorizing committees, they contain terms on minimum tonnage, the SIC code, and other things because this was a program targeted to steel firms, which, by definition, are generally not small businesses.

Mr. **Bedell**. I think there is concern by people in our society that we have programs that say you can qualify, only if you are big enough. If you are not one of the top 20 firms, you will not even qualify for this particular program.

Mr. **Hall**. I would like to elaborate. When you talk about the special steel program——

Mr. **Bedell**. We understand it very clearly. It applies only to the top 20 steel companies in the United States.

Mr. **Hall**. That basically is correct in terms only of the special steel loan guaranty program.

Mr. **Quayle**. Do you think that is a good policy, just to limit it to the top 20?

Mr. **Hall**. It is not exclusive, because in our regular program we assist firms of all sizes.

Mr. **Bedell**. It is exclusive in that program. You have other programs that apply to all firms.

Mr. **Quayle**. That is why I asked.

Mr. **Hall**. In terms of the $550 million steel loan guaranty program and the problems it is intended to address, there was a need to set some size criteria. We think it is a good policy.

Mr. **Quayle**. I think you might have some dispute, not only in this committee, but in the House in general.

Mr. **Hall**. It is a good policy in the sense there is credit available through our regular loan program for the other firms.

Mr. **Quayle**. I realize that, but I just do not think we want to get into a policymaking position of excluding the small- and middle-sized firm. Obviously, in the special steel program, they are going to get it anyway, but to make it exclusionary, I think, is a bad policy.

Please explain how in other programs you have shown sensitivity to the small business. I think they cannot compete with big businesses in the number of accountants, lawyers, and whatever it takes to make applications. We all know that. We have all heard the arguments of big government, big unions, and big business working together.

Please elucidate on how you help small business.

Mr. **Karras**. As Mr. Hall was saying earlier, in terms——

Mr. **Bedell**. My understanding is that Mr. Hall has to leave at 10:45 a.m. Are these questions that others could answer? We want to cooperate with you.

Mr. **Levine**. Mr. Chairman, the staff has a few questions for Mr. Hall. I am sure the minority staff has questions also. We can submit these questions to you in writing.

Mr. **Bedell**. Can you answer Mr. Quayle's question?

Mr. **Hall**. Yes.

Mr. **Karras**. Two-thirds of our projects in the period from 1976 to 1979 were with firms which have assets of under $5 million. To put that in some perspective, in terms of the amount of money involved in each project, we do worry about the fact that the Small Business Administration has the same kinds of programs for working capital and fixed assets.

So, we have sort of a gentleman's agreement with SBA that they would have the first shot at the smaller loans. We, of course, take loans they cannot handle.

If, by the way, there is a small loan and for some reason or other they do not want to do it, we are prepared to look at it.

This new legislation gets EDA involved in a larger loan guarantee program with an incentive feature to affect where the private sector locates facilities. But up to this point, the pattern of the agency has largely been to assist firms expanding at their present locations.

This is what we call our business retention program. They essentially are small firms that find it difficult to get access to private capital markets. Many of them are marginal and many are minority firms. We are saving those firms.

Also, we do an awful lot of work with small firms which are fairly successful and have the capacity to expand.

So, I think you can see from the statistics alone that we are indeed sensitive to the needs of small business as measured by $5 million or less in assets.

Mr. **QUAYLE**. Thank you, Mr. Chairman.

I will have to be excused.

Mr. **BEDELL**. We appreciate your being here, Mr. Quayle.

Do you have a short question?

Mr. **WILLIAMS** of Ohio. If I picked up the gist of this discussion, it is simply this. We bring you a project that falls within the $100 million category. If we could put something together very similar to Wisconsin Steel, for your consideration, I am sure we could get United States Steel to lend some money or pick up the 10-percent cost.

I want to compliment Mr. Williams, Mr. Karras, and yourself for being here. However, I hope you understand the concern we have in an area that has really been hit hard. It does not do much good to have the $225 million set-aside if noboby can use it. It really does not; $100 million of it has been there for 2 years. And yet not one job has been created in the Mahoning Valley, based on an EDA program, other than Commuter Aircraft, and the small funding of the rubber hose plant, which was a few hundred employees. That was separate from the $100 million.

If we are going to answer this, I need to know as their representative how we put together a proposal. I think I would like to bring you one like Wisconsin Steel.

Mr. **BEDELL**. We realize you need to leave.

A large amount of the freedom of information material has had sentences and dates deleted. Is this the customary practice?

Mr. **HALL**. Yes. We have a responsibility, as you can appreciate, to be very careful where there is proprietary financial information.

Mr. **BEDELL**. The deleting of dates on memorandums would be part of that requirement?

Mr. **HALL**. I do not know about the specifics on that.

Mr. **LEVIN**. Ordinarily it would not.

Mr. **BEDELL**. Maybe it is not intentional. There are a lot of memorandums where it looks like the dates have been blocked out.

We are going to furnish written questions. Could we have your answers to those?

Mr. **HALL**. Certainly.

Mr. **BEDELL**. When can we expect those back?

Mr. **HALL**. It would obviously depend on the number and depth of the questions.

Mr. **Levin**. There is quite a bit of information that was requested from this dialog. Would 3 weeks be adequate?

Mr. **Hall**. I certainly think we could do it within 3 weeks.

Mr. **Bedell**. Without objection, so ordered.

[See Appendix X.]

Mr. **Bedell**. We want to thank you for being here. If some of the questions have been rather direct, it is because there are some serious concerns in my mind, as we discussed this Wisconsin Steel project.

I think we may need to change legislation. I think what you did, in my opinion, was contrary to the intent of the Congress in these areas.

I understand you have to leave. We may want to check with you again about seeing that this does not happen in the future.

We appreciate your being here very much.

Mr. **Hall**. Thank you, Mr. Chairman. We appreciate your concerns.

Mr. **Bedell**. Our next witness is Mr. Harold M. Williams, Chairman of the Securities and Exchange Commission.

Before we start, we owe you a deep vote of thanks for your patience. You were scheduled to be first. You have been willing to wait because Mr. Hall had another appointment.

We certainly are very grateful to you for that cooperation. We appreciate your being here very much.

Would you stand and be sworn?

Do you solemnly swear that the testimony you are about to give this subcommittee will be the truth, the whole truth, and nothing but the truth?

Mr. **Harold** M. **Williams**. I do.

Mr. **Bedell**. Do you have a prepared statement?

TESTIMONY OF HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. **Harold** M. **Williams**. Thank you, Mr. Chairman.

Yes, sir. We have submitted a statement for the record.

Mr. **Bedell**. You may either read it or summarize it. We would prefer if you would summarize it if you are in a position to do so.

Mr. **Harold** M. **Williams**. I may read a portion of it and summarize the balance.

Mr. **Bedell**. That is fine, it will all be entered into the record.

Mr. **Harold** M. **Williams**. I am pleased to accept the committee's invitation to discuss the thoughts on tender offers and acquisitions that I raised last month at the Seventh Annual Securities Regulation Institute in San Diego, Calif.

I have submitted to the committee for inclusion in the record the full text of my speech to the institute, which is entitled, "Tender Offers and the Corporate Director." [See Appendix Y.]

As the title of the speech implies, I discussed two interrelated topics. First, I noted my concern over the increasingly common phenomenon of tender offers, especially those that do not enjoy incumbent management's support.

This concern extends to the socioeconomic consequences of such practices, as well as the often inadequate manner in which the management and directors of both the bidding and target corporations address the situation.

Second, I emphasized that, while the public cannot be indifferent to the consequences of the current wave of tender offers and acquisitions, the optimal regulator of such practices would be vigorous boards of directors composed of persons of independent credentials who effectively meet their responsibilities to those groups which have legitimate interests in the decisions which the corporations will make.

In my judgment, it is, therefore, important to sensitize corporations and their directors to the critical roles that boards should play in tender offer situations.

At the outset of my discussion on the socioeconomic consequences of takeovers, I wish to emphasize that much of my discussion today raises issues beyond the scope of the Federal securities laws.

Rather, it represents personal concerns that have developed as a result of my observing this phenomenon from a number of perspectives: As a businessman who has been involved in acquisitions, as an academician, and as a public official.

The Commission's regulatory interest in tender offers is embodied in those parts of the Securities Exchange Act generally called the Williams Act, in recognition of the role played by Senator Harrison Williams in the passage of this legislation.

The Williams Act mandates procedures which give corporate shareholders the opportunity to make a full and informed decision when faced with a tender offer.

But the Williams Act does not provide substantive standards governing whether a takeover is, or is not, appropriate. Indeed, the congressional policy which is clearly expressed by the Williams Act is that the procedures required for a tender offer must be carefully balanced to neither impede nor encourage tender offers.

In observing the increase of takeovers which we have experienced during the last several years, I have come to believe that it is different in several respects from those witnessed in prior decades.

The first, and perhaps the most unsettling, aspect of the current wave of mergers and acquisitions is the legitimacy which hostile tender offers have come to enjoy.

It has become acceptable to treat corporations as the sum of their properties and to assume that corporate control may change hands with no greater concern about the consequences than accompanies an exchange of property deeds in a game of monopoly.

But, a corporation is more than the aggregate of its tangible assets—and more than the equity of its current shareholders—it is an institution with a complex of interpersonal and contractual relationships that create legitimate interests in the corporation among employees, suppliers, customers, communities, and the economy at large.

This new crop of corporate takeovers has been fueled, if not caused, by low stock market prices.

And, in a period of low stock prices and high inflation, managers may see considerable attraction in buying out other corporations or their assets at below their current value in the hope of repaying the resulting debt in depreciated dollars.

Further, the immediate results of a takeover are particularly attractive to a corporate executive who seeks the ego satisfaction, prestige, and remuneration associated with size and the appearance of growth.

In contrast, the impact of investment spending on earnings, and the deferred nature of its rewards, may not seem to be of benefit to current managers or fit with their short-term horizon in office.

Indeed, the investment through the addition of plant and through the development of new products in principle means that you incur the costs first and reap the benefits later; whereas in a takeover the coincidence of cost and benefit is more contemporary.

What public policy issues are raised by this type of activity? Inherent in the overall acquisition wave, exaggerated by the increasing use of hostile tender offers, is a concern about the concentration of this Nation's economic power, as well as the appropriate use of corporate resources in a period of increasing international competition and shrinking U.S. domination, when the United States has the lowest percentage of capital investment, growth in productivity, and savings of any major industrialized society.

In the last 5 years, I would estimate that $100 billion of corporate cash resources—resources which, in my personal opinion, could have been devoted to capital spending, product development and innovation opportunities—have been diverted to rearranging the ownership of existing corporate assets through tenders alone.

These are resources that do not flow back as new capacity, improvements in productivity, new products or new jobs.

Moreover, businessmen are spending increasing attention and energy looking for companies to acquire—and in avoiding being themselves acquired. Sometimes this process results in better, more innovative management; but, too often, it does not.

While I have expressed skepticism about the consequence of some contemporary takeovers, I have also noted my lack of enthusiasm for legislation which would prohibit certain categories of mergers.

Legislation which responds to a wave of mergers and takeovers motivated primarily by a combination of a depressed stock market and, in some instances, regulatory obstacles to other forms of corporate growth, would be just as effective in preventing the consummation of acquisitions which would have real economic and social benefits in terms of efficiency and synergy as it would be in frustrating less rational consolidations.

Moreover, such legislation would likely have the undesirable effect of insulating management from the marketplace check and discipline of a system which squeezes the most inefficient managers out of the system and often replaces them with those who can do better.

I turn now to the role of the board.

For these reasons, I believe that central issue in developing an approach to takeovers is to assure a private sector vehicle which will evaluate acquisitions in terms of the full range of relevant factors—such as whether they make substantive economic sense and deal appropriately with those groups to which the corporation, as an institution, has responsibilities.

In my view, the independent director is the only actor on the corporate scene equipped to play this role.

Conventional thinking concerning the corporate response to the threat of a takeover seems to spring from one or the other of two rather simplistic theories.

One theory is that the marketplace provides a healthy check and discipline to management, and should enjoy unhampered control over the fate of these transactions. That is, the shareholders at that point of time, the presumed owners of the company and beneficiaries of its endeavors, should have the absolute right to determine whether or not to accept the tender.

The opposing theory, advanced quite naturally by those who see themselves as managers rather than shareholders, treats tender offers as a kind of unfair opportunity created by quirks in the markets' valuation of a company or by overall market conditions.

It emphasizes the role of the corporation's directors in representing the corporation as an unique entity, rather than simply seeking the best deal for its individual shareholders.

In discharging this responsibility, directors generally are protected by the business judgment rule from all but the most extreme deviations from what particular shareholders might view as their interest.

In my view, neither of these theories is useful in illuminating the responsibilities of the directors of the parties in a contemporary tender offer situation. The notion that a corporate takeover should stand or fall solely on the marketplace's determination of the sufficiency of an offeror's premium is particularly unsatisfying.

For one thing, true, from the bidder's standpoint, it insures that almost every tender offer—or at least the highest competing tender offer—will succeed.

And, from the target's standpoint, it makes the directors task simple and avoids litigation. But more fundamentally, this theory precludes other than a market value assessment of the corporation, ignores its responsibilities as an institution, and assumes that society would overlook economic decisions which could substantially affect its welfare.

This is simply unrealistic.

Emphasis on marketplace acceptability also fails to come to grips with the legal responsibilities which characterize the corporate form of business. For example, is it a complete answer to the duties which managers and directors owe to shareholders to assume that an above-market tender offer is in the shareholders best interests?

One wonders, as a matter of fundamental fairness, whether the interests of speculators and arbitrageurs, who move in and out of large positions with little regard to the strengths and weaknesses of the underlying enterprise, should be the decisive factor in determining a corporation's future.

Moreover, although I recognize the essential value of marketplace discipline as a prophylactic against poor management, the benefits of that discipline are lost if management must behave as if the corporation is continuously on the block.

For these reasons, the vehicle for balancing the competing concerns which must be weighed in evaluating a tender offer is to be found not in the marketplace but in the corporate board room.

Directors should make the decision, as they do all other corporate policy decisions, and do so based on an assessment of the corporation as an institution with responsibilities to discharge, rather than simply seeking the best deal for their shareholders.

I do not mean, however, that directors should be free to resort to protective measures and then ritualistically invoke the protection of the business judgment rule.

Rather, in my opinion, the courts—in recognizing the significance of takeovers to the economy and to groups of individuals to which the corporation has responsibilities—are beginning to inquire whether, in making such a business judgment, a board of directors has met certain minimum, but increasing, standards to warrant judicial deference.

Those standards relate to the competence of the decision-makers—the directors objectivity and the processes used to arrive at their judgment. The touchstone is whether proper inquiries were made by unbiased and knowledgeable individuals and whether the results of that process were conscientiously considered and applied.

I want now to explore briefly what this concept means in practice to both the board of the bidding corporation and that of the target.

Directors, and particularly independent directors, must play a major role in evaluating the appropriateness of a proposed acquisition.

Without implying a lack of confidence in management, the independent directors must be sensitive to the possibility that management's judgment may be skewed in a particular case.

As I noted earlier, there is an unfortunate tendency on the part of some to assume that bigger is somehow better.

Therefore, to a large extent, it is the independent directors responsibility to satisfy themselves that such an acquisition makes substantive long-term good sense for the company.

They should not merely accept undocumented rhetoric about synergy or the benefits of improved management or financial controls, which may tend to be more illusory than real.

The directors should consider management's prior experiences and track record or its lack of them, in assessing and acquiring target companies, integrating new acquisitions into the corporation, and delivering the anticipated benefits.

In this regard, I should note that the large premiums that have been paid in certain recent acquisitions make one wonder how carefully the bidding corporation's board considered the economic justification for the transaction.

Moreover, in making such a determination, the board of directors has a responsibility also to consider the available alternatives and whether any such alternative would be more in its own shareholders interests.

For example, boards should not ignore that diversification often results in a lower share price and multiple. An alternative course for the company with excess cash might very well be to consider distributing the cash to its own shareholders, rather than to shareholders of a target company.

Such a corporation can give its own shareholders the benefit of the premium to do their own diversifying by reinvesting this distribution—possibly even in the same target company—at the market price rather than at a premium.

As to the other side of the transaction, it is my opinion that an effective board of directors also remains the institution best suited to weigh the often conflicting factors that may influence a response when the corporation is the target of an acquisition proposal or tender offer.

However, I also must emphasize my belief that this role for the board also involves special responsibilities for competence and objectivity. I believe that a board's actions in response to a tender offer should increasingly focus on two important questions.

The first question regards the credentials of the decisionmakers. The most important credentials, of course, are competence and objectivity.

To satisfy such an inquiry, I would expect to find an increasing number of instances in which a corporation's board delegates to a special committee of independent directors the investigation of an offer and the recommendation to the full board of an appropriate response.

The second question regards the substance of the process to be followed by the board in determining whether the offer is in the best interests of the corporation and its shareholders.

In addition to analyzing the offer's terms, the board, as I already noted, has an institutional responsibility to consider such concerns as: The potential adverse impact on employees, suppliers, and communities; any likely antitrust limitations; whether the offer is for less than all outstanding securities, which raises the specter of a residual minority which may be locked into their investments; and any likely discontinuation of unique goods or services to the public.

The key, however, is the substance as contrasted to the window dressing and the rhetoric used to dress up an otherwise unjustified defense.

While encouraging the board to consider the impact of a takeover on groups to whom the corporation has responsibilitics, I do not endorse antitakeover provisions of this or any other sort, by charter or bylaw designed to make the company a less attractive target.

Although I recognize the desirability for management to be able to run its company without continually looking over its shoulder, I believe that tenders should be considered on their merits, on a case-by-case basis, and not warded off by building castles and moats.

I turn now to small business.

The hostile tender offer is not the primary threat to the continuing independent of many businesses. Usually, most small businesses which are the subject of an acquisition are acquired in a friendly context.

In many such cases, the owners of the small business typically view the acquisition as the best available source of needed capitalization. In other cases, the small business owners are receptive to an acquisition offer because the securities of the acquiring company which they will receive in the transaction are often more marketable than the securities of their small business.

In appreciation of the importance of a strong, independent small business sector of our national economy, the Commission last year established the Office of Small Business Policy within its Division of Corporate Finance to spearhead the Commission's small business rulemaking initiatives, to analyze the impact of the Commission's activities on small issuers, and to serve as a liaison with the small business community.

As a result of that office's recommendations, the Commission has taken a number of steps which should facilitate capital formation by smaller businesses.

As illustrations, the Commission has liberalized the rule regarding resale of restricted securities, which will increase their marketability; and adopted a new "short-form" registration statement for certain smaller issues of securities and created a new exemption from registration for other types of relatively small issues of securities, which should facilitate the capital-raising process.

Additionally, the Commission increased the aggregate amount of securities which may be sold pursuant to its small offering regulation, which also should facilitate public offerings.

In conclusion, let me return to the principle to which I have referred in a number of my talks across the Nation:

Under the American system anyone who exercises power needs to be held accountable to someone else for his stewardship. Acquisitions and tender offers are perceived correctly to involve the exercise of considerable power—that is, the ability to influence many persons' lives and futures.

Jobs, the welfare of entire communities, and, indeed, the national economy undoubtedly will be affected by these transactions. This Nation cannot—and will not—allow matters of such vital significance to be unaccountable to rational decisionmakers who are acting according to publicly acceptable norms.

I strongly advocate that this decisionmaking role for tender offers be filled by vigorous boards of directors composed of persons of independent credentials who effectively meet the responsibilities of their office.

In my opinion, only boards of directors can properly balance the competing and often conflicting interests that are unique to each particular takeover situation.

Legislation, in contrast, necessarily must address issues in terms of generalities, which is an approach that is not conducive to resolving these conflicts in any sensitive and appropriate way.

I would be pleased to answer any questions which the subcommittee may have.

Mr. BEDELL. Thank you.

[Mr. Williams' prepared statement follows:]

PREPARED STATEMENT OF HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman, I am pleased to accept the Committee's invitation to discuss the thoughts on tender offers and acquisitions that I raised last month at the Seventh Annual Securities Regulation Institute in San Deigo, California. I have submitted to the Committee for inclusion in the record the full text of my speech to the Institute which is entitled "Tender Offers and the Corporate Director."

best copy available

As the title of the speech infers, I discussed two interrelated topics. First, I noted my concern over the increasingly common phenomenon of tender offers, especially those that do not enjoy incumbent management's support. This concern extends to the socioeconomic consequences of such practices as well as the oft-inadequate manner in which the management and directors of both the bidding and target corporations address the situation. Second, I emphasized that, while the public cannot be indifferent to the consequences of the current wave of tender offers and acquisitions, the optimal regulator of such practices would be vigorous boards of directors composed of persons of independent credentials who effectively meet their responsibilities to those groups which have legitimate interests in the decisions which the corporations will make. In my judgment, it is, therefore, important to sensitize corporations and their directors to the critical roles that boards should play in tender offer situations.

At the outset of my discussion on the socioeconomic consequences of takeovers, I wish to emphasize that much of my discussion today raises issues beyond the scope of the Federal securities laws. Rather, it represents personal concerns that have developed as a result of my observing this phenomenon from a number of perspectives—as a businessman who has been involved in acquisitions, as an academician, and as a public official.

The Commission's regulatory interest in tender offers is embodied in those parts of the Securities Exchange Act generally called the Williams Act, in recognition of the role played by Senator Harrison Williams in the passage of this legislation. The Williams Act mandates procedures which give corporate shareholders the opportunity to make a full and informed decision when faced with a tender offer. But the Williams Act does not provide substantive standards governing whether a takeover is—or is not—appropriate. Indeed, the Congressional policy which is clearly expressed by the Williams Act is that the procedures required for a tender offer must be carefully balanced to neither impede nor encourage tender offers.

In observing the increase of takeovers which we have experienced during the last several years, I have come to believe that it is different in several respects from those witnessed in prior decades. The first, and perhaps most unsettling, aspect of the current wave of mergers and acquisitions is the legitimacy which hostile tender offers have come to enjoy. It has become acceptable to treat corporations as the sum of their properties and to assume that corporate control may change hands with no greater concern about the consequences than accompanies an exchange of property deeds in a game of Monopoly. But, a corporation is more than the aggregate of its tangible assets—and more than the equity of its current shareholders—it is an institution with a complex of interpersonal and contractual relationships that create legitimate interests in the corporation among employees, suppliers, customers, communities, and the economy at large.

This new crop of corporate takeovers has been fueled—if not caused—by low stock market prices. And, in a period of low stock prices and high inflation, managers may see considerable attraction in buying out other corporations or their assets at below their current value in the hope of repaying the resulting debt in depreciated dollars. Further, the immediate results of a takeover are particularly attractive to a corporate executive who seeks the ego satisfaction, prestige, and remuneration associated with size and the appearance of growth. In contrast, the impact of investment spending on earnings, and the deferred nature of its rewards, may not seem to be of benefit to current managers or fit with their short-term horizon in office.

What public policy issues are raised by this type of activity? Inherent in the overall acquisition wave, exaggerated by the increasing use hostile tender offers, is a concern about the concentration of this nation's economic power, as well as the appropriate use of corporate resources in a period of increasing international competition and shrinking U.S. domination—when the United States has the highest percentage of obsolete plants, and the lowest percentage of capital investment, growth in productivity and in savings of any major industrialized society. In the last five years, I would estimate that $100 billion of corporate *cash* resources—resources which in my personal opinion could have been devoted to capital spending, product development and innovation opportunities—have been diverted to rearranging the ownership of existing corporate assets through tenders alone. These are resources that do not flow back as new capacity, improvements in productivity, new products or new jobs. Moreover, businessmen are spending increasing attention and energy looking for companies to acquire—and in avoiding being themselves acquired. Sometimes this process results in better, more innovative managment; but, too often, it does not.

While I have expressed skepticism about the consequence of some contemporary takeovers, I have also noted my lack of enthusiasm for legislation which would prohibit certain categories of mergers. Legislation which responds to a wave of mergers and takeovers motivated primarily by a combination of a depressed stock market and, in some instances, regulatory obstacles to other forms of corporate growth, would be just as effective in preventing the consummation of acquisitions which would have real economic and social benefits in terms of efficiency and synergy as it would be in frustrating less rational consolidations. Moreover, such legislation would like have the undesirable effect of insulating management from the marketplace check and discipline of a system which squeezes the most inefficient managers out of the system and often replaces them with those who can do better.

ROLE OF THE BOARD

For these reasons, I believe the central issue in developing an approach to takeovers is to assure a private sector vehicle which will evaluate acquisitions in terms of the full range of relevant factors—such as whether they make substantive economic sense and deal appropriately with those groups to which the corporation, as an institution, has responsibilities. In my view, the independent director is the only actor on the corporate scene equipped to play this role.

Conventional thinking concerning the corporate response to the threat of a takeover seems to spring from one or the other of two rather simplistic theories. One theory is that the marketplace provides a healthy check and discipline to management, and should enjoy unhampered control over the fate of these transactions. That is, the shareholders at that point of time, the presumed owners of the company and beneficiaries of its endeavors, should have the absolute right to determine whether or not to accept the tender. The opposing theory, advanced quite naturally by those who see themselves as managers rather than shareholders, treats tender offers as a kind of unfair opportunity created by quirks in the markets' valuation of a company or by overall market conditions. It emphasizes the role of the corporation's directors in representing the corporation as unique entity; rather than simply seeking the best deal for its individual shareholders. In discharging this responsibility, directors generally are protected by the business judgment rule from all but the most extreme deviations from what particular shareholders might view as their interest.

In my view, neither of these theories is useful in illuminating the responsibilities of the directors of the parties in a contemporary tender offer situation. The notion that a corporate takeover should stand or fall solely on the marketplace's determination of the sufficiency of an offeror's premium is particularly unsatisfying. For one thing, true, from the bidder's standpoint, it ensures that almost every tender offer—or at least the highest competing tender offer—will succeed. And, from the target's standpoint, it makes the directors' task simple and avoids litigation. But more fundamentally, this theory precludes other than a market value assessment of the corporation, ignores its responsibilities as an institution and assumes that society would overlook economic decisions which could substantially affect its welfare. This is simply unrealistic.

Emphasis on marketplace acceptability also fails to come to grips with the legal responsibilities which characterize the corporate form of business. For example, is it a complete answer to the duties which managers and directors owe to shareholders to assume that an above-market tender offer is in the shareholders' best interests? One wonders, as a matter of fundamental fairness, whether the interests of speculators and arbitrageurs, who move in and out of large positions with little regard to the strengths and weaknesses of the underlying enterprise, should be the decisive factor in determining a corporation's future. Moreover, although I recognize the essential value of marketplace discipline as a prophylactic against poor management, the benefits of the discipline are lost if management must behave as if the corporation is continuously on the block.

For these reasons, the vehicle for balancing the completing concerns which must be weighed in evaluating a tender offer is to be found not in the marketplace but in the corporate boardroom. Directors should make the decision, as they do all other corporate policy decisions, and do so based on an assessment of the corporation as an institution with responsibilities to discharge, rather than simply seeking the best deal for their shareholders. I do not mean, however, that directors should be free to resort to protective measures and then ritualistically invoke the protection of the business judgment rule. Rather, in my opinion, the courts—in recognizing the significance of takeovers to the economy and to groups of individuals to which the corporation has responsibilities—are beginning to inquire whether, in making such a business judgment, a board of directors has met certain minimum, but increasing, standards to warrant judicial deference. Those standards relate to the competence of the decisionmaker—the directors' objectivity and the processes used to arrive at their judgment. The touchstone is whether proper inquiries were made by unbiased and knowledgeable individuals and whether the results of that process were conscientiously considered and applied. I want now to explore briefly what this concept means in practice to both the board of the bidding corporation and that of the target.

Directors, and particularly independent directors, must play a major role in evaluating the appropriateness of a proposed acquisition. Without implying a lack of confidence in management, the independent directors must be sensitive to the possibility that management's judgment may be skewed in a particular case. As I noted earlier, there is an unfortunate tendency on the part of some to assume that bigger is somehow better. Therefore, to a large extent, it is the independent directors' responsibility to satisfy themselves that such an acquisition makes substantive long-term good sense for the company. They should not merely accept undocumented rhetoric about synergy or the benefits of improved management or financial controls, which may tend to be more illusory than real. The directors should consider management's prior experiences and track record or its lack of them in assessing and acquiring target companies, integrating new acquisitions into the corporation, and delivering the anticipated benefits. In this regard, I should note that the large premiums that have been paid in certain recent acquisitions make one wonder how carefully the bidding corporation's board considered the economic justification for the transaction.

Moreover, in making such a determination, the board of directors has a responsibility also to consider the available alternatives and whether any such alternative would be more in its own shareholders' interests. For example, boards should not ignore that diversification often results in a lower share price and multiple. An alternative course for the company with excess cash might very well be to consider distributing the cash to its own shareholders, rather than to shareholders of a target company. Such a corporation can give its own shareholders the benefit of the premium to do their own diversifying by reinvesting this distribution—possibly even in the same target company—at the market price rather than at a premium.

As to the other side of the transaction, it is my opinion that an effective board of directors also remains the institution best suited to weigh the oft-conflicting factors that may influence a response when the corporation is the *target* of an acquisition proposal or tender offer. However, I also must emphasize my belief that this role for the board also involves special responsibilities for competence and objectively. I believe that a board's actions in response to a tender offer should increasingly focus on two important questions.

The first question regards the credentials of the decision-makers. The most important credentials, of course, are competence and objectivity. To satisfy such an inquiry, I would expect to find an increasing number of instances in which a corporation's board delegations to a special committee of independent directors the investigation of an offer and the recommendation to the full board of an appropriate response.

The second question regards the substance of the process to be followed by the board in determining whether the offer is in the best interests of the corporation and its shareholders. In addition to analyzing the offer's terms, the board, as I already noted, has an institutional responsibility to consider such concerns as: the potential adverse impact on employees, suppliers, and communities; any likely antitrust limitations; whether the offer is for less than all outstanding securities, which raises the spector of a residual minority which may be locked into their investments; and any likely discontinuation of unique goods or services to the public. The key, however, is the substance as contrasted to the window dressing and the rhetoric used to dress up an otherwise unjustified defense.

While encouraging the board to consider the impact of a takeover on groups to whom the corporation has responsibilities, I do not endorse anti-takeover provisions of this or any other sort, by charter or by-law designed to make the company a less attractive target. Although I recognize the desirability for management to be able to run its company without continually looking over its shoulder, I believe that tenders should be considered on their merits, on a case-by-case basis, and not warded-off by building castles and moats.

SMALL BUSINESS

The hostile tender offer is not the primary threat to the continuing independence of many businesses. Usually, most small businesses which are the subject of an acquisition are acquired in a friendly context. In many such cases, the owners of the small business typically view the acquisition as the best available source of needed capitalization. In other cases, the small business owners are receptive to an acquisition offer because the securities of the acquiring company which they will receive in the transaction are often more marketable than the securities of their small business.

In appreciation of the importance of a strong, independent small business sector of our national economy, the Commission last year established the Office of Small Business Policy within its Division of Corporation Finance to spearhead the Commission's small business rulemaking initiatives, to analyse the impact of the Commission's activities on small issuers, and to serve as a liaison with the small business community.

As a result of that Office's recommendations, the Commission has taken a number of steps which should facilitate capital formation by smaller businesses. As illustrations, the Commission has liberalized the rule regarding resale of restricted securities, which will increase their marketability; and adopted a new "short-form" registration statement for certain smaller issues of securities and created a new exemption from registration for other types of relatively small issues of securities, which should facilitate the capital-raising process. Additionally, the Commission increased the aggregate amount of securities which may be sold pursuant to its small offering regulation, which also should facilitate public offerings.

CONCLUSION

In conclusion, let me return to the principle to which I have referred in a number of my talks across the nation: Under the American system, anyone who exercises power needs to be held accountable to someone else for his stewardship. Acquisitions and tender offers are perceived correctly to involve the exercise of considerable power—that is, the ability to influence many persons' lives and futures. Jobs, the welfare of entire communities, and, indeed, the national economy undoubtedly will be affected by these transactions. This nation cannot—and will not—allow matters of such vital significance to be unaccountable to rational decision-makers who are acting according to publicly-acceptable norms. I strongly advocate that this decision-making role for tender offers be filled by vigorous boards of directors composed of persons of independent credentials who effectively meet the responsibilities of their office. In my opinion, only boards of directors can properly balance the competing and oft-conflicting interests that are unique to each particular takeover situation. Legislation, in contrast, necessarily must address issues in terms of generalities, which is an approach that is not conducive to resolving these conflicts in any sensitive and appropriate way.

I would be happy to answer any questions which the Subcommittee might have.

Mr. **Bedell.** Do you have any questions, Mr. Williams?

Mr. **Williams** of Ohio. No, Mr. Chairman; although I do find the testimony useful.

Mr. **Bedell.** If I understood you correctly, you said we should leave it up to the corporate director and hope that he would solve the problem that any takeover be politically, economically, and socially justifiable.

How do we do that?

Mr. **Harold** M. **Williams.** Well, in part we do it by talks such as the one I gave in San Diego.

I think what we generally are experiencing, and I believe what is happening on the corporate scene, is an increasing sensible awareness on the part of the corporate community of their responsibilities and of the consequences of their actions or inactions, and, indeed, of the undesirability of the alternatives, and, almost of necessity, the prescriptive nature of Federal legislation or regulation, and of the desirability that the positive consequences, for example, of tender offers be protected.

Mr. **Bedell.** Will it be foolproof or fail-safe?

Mr. **Harold** M. **Williams.** No, sir.

Mr. **Bedell.** We have just had testimony before this subcommittee that United States Steel in Youngstown, Ohio, has said they will not sell their plant to any competitor. They will close them down.

It would seem to me that is not in the social interest, the national interest, or any other interest, considering we are behind other nations in regard to steel production.

I do not know if that testimony is correct or not. We will find out.

Certainly the measurement for corporate success is profit and growth. It is not what you do for your community, but is measured in terms of the interest of the stockholders.

I do not disagree with what you are trying to say, but I think we have our head in the sand if we think that United States Steel, or any other similar corporation, is going to be primarily concerned about what they do for their community rather than the profits they make for their stockholders.

Mr. **Harold** M. **Williams**. If you put it in terms of "primarily," Mr. Chairman, I would agree with you. I see here a much greater degree of sensitivity that there is something more than profits involved. There are responsibilities involved to employees and to customers and communities and others.

Those are not inconsistent with the long-term view of corporate growth and profitability. But it is a different emphasis than I believe has historically been the case on the part of many corporations.

Mr. **Bedell**. Do you think the board of directors really makes the policy in those situations?

Mr. **Harold** M. **Williams**. It varies from corporation to corporation.

Is that enough? No. I think it depends on how you define it. I think that more often than not, in a matter of such magnitude, the board has an opportunity to make policy.

Mr. **Bedell**. That is not my question.

Mr. **Harold** M. **Williams**. I know. I am coming to it.

Typically the initiative will come from management. The final decision has to be the board's. The core question, then, is how well and how often does the board discharge that responsibility.

There I would say, increasingly well and often. And, the increased sensitivity is due to a variety of reasons, some of which are the products of everything from public disapproval to concern about legislation, to litigation on the part of private parties, shareholders, and others, and congressional criticism.

There are a myriad of factors.

I think that, as a result of the growing consciousness of the relevance of these factors, the scene is changing.

Mr. **Bedell**. In your statement you made the point of the large amount of capital that could have been used more effectively, in your opinion, for improving productivity rather than involved in tender offers or takeovers.

Are there changes we would need in the laws or in our governmental policies that would help to bring about the change you would like to see, which would be that money would be invested in increased productivity rather than takeovers?

Mr. **Harold** M. **Williams**. I do not think prescriptive legislation in relation to mergers is the answer.

I think the merger wave is symptomatic of situations where one can buy assets in the market at substantially below their replacement cost, when the uncertainty of appropriate investment is what it is, where you have substantial leadtimes in terms of building new plants, uncertainty both economically and, in many cases in a regulatory sense—in terms of when you can get that plant downstream, what the costs will ultimately be of having built that plant, and what kind of regulatory problems you will run into in the process.

There are a number of regulatory, economic, and political uncertainties that contribute to the problem.

I would say if I were back in the private sector at this point, the pragmatic approach to growth is through acquisition today. It is not through capital investment in new plants and facilities, or in research and development.

Therefore, it seems to me the key lies not in proscribing mergers, but in getting back to the more fundamental reasons of why does our economy today provide the kinds of incentives that it does and not other kinds.

I think they relate back to the problem of inflation and to the lack of adequate incentives for new investments—which is due, not only to regulatory policy, but also to economic and tax policy.

Mr. **Bedell.** What changes in tax policy, regulatory policy, or other government policy, do you think would contribute toward moving the economy in a direction to increase our productivity and not spend a dime trying to buy each other out?

Mr. **Harold** M. **Williams.** I would have to come back to you on that. There are many people spending a lot of time on that. I have some ideas, but I do not know whether they are big enough.

I would like to see some acceleration of depreciation I do believe that a faster writeoff in today's context would have incentive value.

I have spoken on the issue of regulatory reform. My views are somewhat different from many of the proposals that are in the Congress. I do believe that as a matter of policy, there are problems presented by regulation that could be looked at in terms of national policy in terms of their effect on what we are talking about here.

I would be glad to submit my thoughts on that, if you wish. [See Appendix Z.]

Mr. **Bedell.** I have two questions that come to mind. Faster depreciation means that they can build capital more rapidly. Then I see United States Steel, for example, who has not even reinvested to the equivalent of inflation during the last 3 years in their own subbusiness. But they have taken the money and invested it in other businesses.

If we get faster depreciation, it could give them more money to spend on trying to enter in the acquisition market rather than trying to modernize their facilities in a manner so they would be better world competitors.

This is the problem. Am I correct that it is not certain that faster depreciation would necessarily mean they would spend the extra money to replace facilities; to improve, and to update their own facilities?

Mr. **Harold** M. **Williams.** That is true. I think there are two points to be made there.

If the faster depreciation is limited to new facilities instead of acquired facilities, at least you have an incentive for new facilities being built—as contrasted to facilities being acquired. And an acceleration of depreciation provides an additional incentive and a shorter term return.

Mr. **Bedell**. That is not the case now, is it?

Let us say you have a plant. You depreciate off so much. Then you sell it to me. Can I not start right then to depreciate even at the price paid?

Mr. **Harold** M. **Williams**. That is right.

Mr. **Bedell**. So, I gain as much from depreciation in buying your plant as if I would in putting new equipment into my own plant?

Mr. **Harold** M. **Williams**. That is correct. But I am not a tax expert.

Mr. **Bedell**. So you would feel there should be a differential. If I buy another business I should have the lower appreciation than if——

Mr. **Harold** M. **Williams**. To the extent that some of these proposals being talked about provide additional acceleration, not depreciation, that additional acceleration could certainly be limited to newly constructed facilities as contrasted to acquired.

So, an incremental incentive would be provided, the purpose of which would be to stimulate new production.

But the second point I have to say relates to what I assume would still be happening—I hope it would not. Any company would be looking at it for investment opportunities and the relative investment opportunities.

If the determination is that it could do better with an amount of investment capital in an industry other than the one it is in, then I expect they would go in that direction.

The question is: What does that tell us about the viability of the industry? Again, that probably is not a simple issue.

I suspect that requires a very fundamental look.

Mr. **Bedell**. So you think we should continue to have a steel industry in the United States?

Mr. **Harold** M. **Williams**. I would think so.

Mr. **Bedell**. So, it is not like horseshoes so far as viability is concerned.

Mr. **Harold** M. **Williams**. Not at all.

Mr. **Bedell**. We have to find out why it is not viable.

Mr. **Harold** M. **Williams**. That is right.

Mr. **Bedell**. Part of the problem is that you can buy an apartment house and make more money because of the appreciation of the apartment house than you can by reinvesting in your steel facility and modernizing it to compete with foreign steel.

There is something wrong with our society.

Mr. **Harold** M. **Williams**. Yes, sir.

Mr. **Bedell**. You are going to send me the answers?

Mr. **Harold** M. **Williams**. I will send you all these answers.

Mr. **Bedell**. I would want you to write them down as well.

Mr. **Harold** M. **Williams**. It will take more thought. Seriously, I do not profess to have the answers. I do have some thoughts, though.

Mr. **Bedell**. There is another problem. You indicated that many acquisitions are friendly acquisitions. But still do we not have the problem that in most cases the acquiring company is larger than the company to be acquired?

If that is the case, and if it is also correct that it is more and more difficult for entrepreneurs and small corporations to start new projects and be successful, are we not finally headed toward a time when everything will be controlled just by the few very, very large corporations?

Mr. **Harold** M. **Williams**. Yes, sir.

Mr. **Bedell**. Whether it is friendly or unfriendly, if the acquirer is usually a larger fish eating a smaller fish, and if it is very difficult for a small fish to develop any more, it would appear that eventually all you will have are large fish.

Mr. **Harold** M. **Williams**. Yes; that is very troublesome.

To go back over the history of the country, most of the developments have been by small business. I think the future viability of the business economy depends very heavily on the continued growth of small business.

So, I do share that concern very much.

Again, I do not think we deal with that by putting the lid on mergers. You have to deal with the small business aspect itself and what their problems are.

Mr. **Bedell**. I think our staff has some questions.

Ms. Hoppe?

Ms. **Hoppe**. Thank you, Mr. Chairman.

If I could, I would like to follow up on one point.

As you were just saying, you do not believe that prescriptive legislation banning mergers is the answer. Could you expand on that?

Are you against all legislation that would limit mergers and acquisitions or just certain types?

Mr. **Harold** M. **Williams**. I am not aware of any legislative proposals that seem to me to draw the kind of lines that I think make sense.

Basically, as I have indicated, I think the merger waves are, in many instances, consequences rather than causes. I think it is more important to look at the causes than to try to deal with the consequences.

Second, there are some very positive aspects to mergers. There is a marketplace discipline at work here. There is a discipline brought to bear on the so-called inadequate management, when you talk about hostile mergers.

Beyond that, there are some mergers that do make some real economic sense and do provide the kind of synergy that mergers are supposed to provide.

To answer you specifically, I have not tried exhaustively, in my own mind, to think whether there might be some way that a line might be drawn that would make more sense than nonsense.

I have not found it.

Mr. **Bedell**. Mr. Levin?

Mr. **Levin**. Thank you, Mr. Chairman.

You just mentioned the term "merger wave." What is a merger wave?

Mr. **Harold** M. **Williams**. Well, I do not have the statistics with me, but I can get them for you. As I indicated, in the so-called hostile area alone, in the last 5 years, there has been over $100 billion invested where the offers have been successful.

There are a number of instances, clearly, where they have not been successful.

In addition——

Mr. **Levine**. How many companies is that?

Mr. **Harold** M. **Williams**. I would have to get you the number. I would guess we are talking about several hundred. I will have to get it for you.

We go through cycles. The merger movement was very popular in the 1960's. It was a different kind of movement at that time. It was motivated differently, I think.

Primarily they were what I would call paper mergers. They were exchanges of stock and other securities.

Then in the 1970's, the early 1970's, it pretty well died down. It began to pick up some momentum about 1974 and 1975. The uniqueness of today's system is that the mergers are now largely for cash because of the depressed stock market.

But in terms of just how big the wave is, in order to quantify it, I will have to submit it for the record. [See Appendix AA.]

Mr. **Levine**. Thank you.

Mr. **Bedell**. We appreciate very much your being here. Again, I want to thank you for you cooperation. I really look forward to the answers you are going to send me.

Mr. **Harold** M. **Williams**. I do not want to over promise. It is an area that I have testified about at other times. But I will be glad to share my thoughts on that.

Mr. **Bedell**. Without objection, so ordered.

[See Appendix Z.]

Mr. **Bedell**. We appreciate your testimony.

The hearing is adjourned.

[Whereupon, at 11:25 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

CONGLOMERATE MERGERS—THEIR EFFECTS ON SMALL BUSINESS AND LOCAL COMMUNITIES

THURSDAY, FEBRUARY 28, 1980

House of Representatives, Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business of the Committee on Small Business,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2359-A, Rayburn House Office Building, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

Mr. Bedell. The subcommittee will come to order.

OPENING STATEMENT OF CHAIRMAN BEDELL

This is the final hearing in the Antitrust Subcommittee's study of conglomerate mergers and their effects on small business and local communities. We did not undertake this study with any specific legislation before us, nor did we set out to prove any particular theory or to make any specific points. Instead, we have sought to build a record so that the controversial issue of conglomerate mergers can be better understood by the Congress and the public.

We had anticipated that Congressman Peter Kostmayer of Pennsylvania would be our first witness this morning, but apparently Mr. Kostmayer was called away on business and will simply submit a statement for the record.

Without objection, the record will remain open at this point for the purpose of inserting Mr. Kostmayer's statement upon receipt.

[Mr. Kostmayer's statement follows:]

Statement of Hon. Peter H. Kostmayer, a Representative in Congress From the State of Pennsylvania

Mr. Chairman and members of the committee, I am grateful for this opportunity to discuss with you the issue of conglomerates, firm shutdowns, and the importance of small business in creating jobs.

I am not an economist nor am I an expert on conglomerate behavior. I am a strong believer in economic democracy and the place of small business in a system of free enterprise with democratic constraints. I bring to this session only these principles and my experience over the last four years in developing legislation to encourage worker ownership of small businesses as a viable alternative for citizens and communities when a profitable business would otherwise be forced to shut down. A provision to encourage job preservation through worker ownership passed the Congress as part of the National Public Works and Economic Development Act of 1979 and is now in conference. This provision is based on legislation which I authored along with my colleagues Stan Lundine and Mathew McHugh of New York.

I commend this subcommittee for looking at the effects of conglomerate mergers because I believe the behavior of some large corporations and conglomerates threaten our economic system in an indirect but important way. I am familiar with some of the evidence of conglomerates and employment presented thus far to the committee, and I know that you have roundly condemned conglomerates and big corporations and recommended government action to deal with them. Others have claimed that the business freedom and profit-making activity cannot be limited in a free economic system without destroying that system. I am not interested today in such sweeping conclusions. I would like to draw some reasonable and modest conclusions and suggest some positive action we can take.

First, there is no controversy over the fact that small and independent businesses account for most of the job creation in the economy. Professor David Birch of the Massachusetts Institute of Technology indicates that 66 percent of all new jobs in the U.S. are being generated by firms with 20 or fewer employees, with small independent firms generating 52 percent of the total, while middle-sized and large firms provide relatively few new jobs. This does not prove that big business is "bad," but it certainly suggests that small business is very, very good for the country. I think we must get beyond a language of condemnation here.

Second, it is very clear that job opportunities do disappear because of business changes and business failures. Birch says 8 percent of all jobs are lost each year due to firm deaths and contractions. This figure is about the same in all regions of the country. Our goal then is not to prevent change in the job market alone, but to make sure that job creation works well, and that jobs are not lost for poor or accidental reasons.

Third, the replacement jobs in our economy, according to the Council of State Planning Agencies and Birch's MIT data, come 80 percent from firms which are less than 4 years of age. Half of these come from new companies and half from expansions of existing companies, and 40 percent of the new jobs and a full 60 percent of the expansions are produced by independent small businesses. Thus, the future of job creation is with the small independent firm.

A closer analysis of the Birch data presented to the Subcommittee by Professors Harrison of MIT and Bluestone of Boston College indicates that the situation is even worse than Birch reports because of certain untracked closings which they included in their statistics.

Fourth, conglomerates have clearly, according to Professor Harrison—and let's remember that is a Dun and Bradstreet data source covering 82 percent of all private sector employment—"been responsible for a disproportionate number of closings relative to openings compared with other forms of ownership."

Each of these facts alone may not be disturbing, but if we add them, that is, add the poor performance of big business and conglomerates in job creation with their record in job loss, we arrive at the modest conclusion that conglomerate growth has not contributed to the economic development of our country and may in the long run be counterproductive.

These facts will not go away, and we must, as the peoples' representatives, try to reflect on them creatively. Let me say that my main approach is not to naively suggest that somehow magically conglomerates and large corporations can be controlled or their actions severely limited. Many such proposals have been made. I, for example, have supported legislation to limit vertical and horizontal integration among energy companies. But, it is my belief that while a realistic proposal may surface to discourage conglomerate ownership and encourage small and independent business, our fighting over the most extreme of these proposals is likely to serve as a very convenient "red herring" to prevent us from acting to *encourage* the kind of economic development that does the most good. If the Fortune 1000 firms have contributed less than ½ of 1 percent of the new jobs created here since 1969 they do not deserve to be the main source of our discussions and deliberations.

What can we do to encourage maximum economic development rather than encourage maximum growth of U.S. conglomerates that invest their profits and energies overseas?

First, we must look at occupational trends. Service employment is now accounting for much more than 50 percent of jobs in most areas. Manufacturing is on the decline, not just because of run-away plants, but because of automation and a general transition to a service economy. In 1960, the 200 largest corporations in America held 47 percent of the nation's manufacturing assets. By 1972, the figure had risen to 60 percent. This is a significant change, a concentration of economic resources in conglomerates which are increasingly super-national, owing allegiance to no single country. We should realize that conglomerates have not yet moved into service-oriented areas. With manufacturing assuming less importance in the economy, I suggest we begin an aggressive policy of encouraging small business investment in service industries, whether it be computer, day care centers, energy processing or whatever. This would be an effective way to maximize broad-based ownership in the economy, encourage job creation, and minimize job loss at the same time.

Second, small businesses need more capital. To quote again from the Council of State Planning Agencies:

> As pointed out in an excellent recent study by Michael Kieschnick and Belden Daniels for the Development Finance Project of the National Rural Center and the Opportunity Funding Corporation, the failings of private capital markets have had a critical impact on young, independent enterprises; indeed, they have kept these otherwise profitable and productive firms from generating the income, profits, and jobs they surely would have had they been able to contend equally for capital with larger firms.
>
> The financing of most new enterprises is a hit-or-miss struggle against highly-stacked odds. It is most often the owner's personal savings which provide the main source of start-up equity—occasionally supplemented with limited indirect funds from commercial banks, venture capitalists, credit unions, and finance and insurance companies.
>
> Small firms typically have more than a third of their capital in the form of debt—normally payable in the short or mid-term (one to five years)—and virtually all as commercial bank loans rather than long-term bonds. The reason is simple: new and small enterprises face enormous barriers in acquiring funds in the long-term debt and equity markets—a difficulty that appears remarkably unjustified on the basis of differences in their collective rate of return or risk.
>
> For example, between 1972 and 1976, and adjusting the figures to include the impact of failure rates, manufacturing firms with less than $1 million in assets produced an average after-tax return of 16 percent on equity, while firms over $1 million in assets returned only 13 percent.
>
> These difficulties are causing small firms to turn to larger firms for the capital they need to grow. In 1976, for example, 75 percent of corporate acquisitions were of firms with less than $1 million in assets. To grow, these firms must give up their independence. And when this happens, the absorbed firm tends to grow more slowly, to generate fewer new jobs, and to create less economic activity.

A strong Small Business Administration is needed to work with small businesses.

Third, our strategies for helping small businesses have been narrow—concentrating on dollars and cents—and not on the broader issues of productivity and growth. You are familiar I am sure with the HEW report on Work issued three administrations ago which showed the American workforce to have one of the highest rates of absenteeism, mental stress and downright alienation of any work force in the world. Today we read that the U.S. has one of the lowest rates of productivity growth among western nations. I do not blame the workers of America or unions for this. I do blame the quality of working life—the way work is organized and workplace decisions made. According to much recent research, this is the *key* element to determining economic success and productivity. As Harvard professor Joseph Blasi has said, "Improving the quality of work life which includes such experiments as worker ownership in business and worker participation in management and reorganization of work, presents the only sure way to make small business a completely re-tooled, vibrant, efficient, more broadly democratic engine of economic change and job creation in the U.S. economy. It is an absolute shame that big business and conglomerates use some quality of work life approaches which are not sufficiently understood and applied in small businesses."

Mr. Chairman, I would like to see the SBA take a comprehensive approach to the improvement of small business which emphasizes *human* capital as much as financial capital. I would like to see the SBA possess the capacity to show small business-people the practical alternatives for improving working life. Recently, the president of the New York Stock Exchange called for a broadbased emphasis on the quality of working life and worker participation in management, to improve American business.

Declining productivity is one of the major causes of inflation. The less we produce, the more inflation grows. Employee and worker ownership in businesses has proven to be exemplary in improving both productivity and profitability. When I testified with Robert Strauss, then the President's anti-inflation advisor, before the Senate Finance Committee last year, he called employee ownership one of the most effective long-term solutions to the problem of inflation in this country. The University of Michigan Institute For Social Research under Arnold Tannenbaum has done research for EDA praising worker ownership in the same way. Hearings on our bills have been replete with example after example of increased productivity and profitability and even complete turn-arounds in firms when such ownership is introduced.

I submit that employee and worker ownership has enormous potential in small business. Three of the largest associations of small businesses in the U.S. endorsed our Small Business Employee Ownership legislation (H.R. 3056 and S. 388 which became part of the still held-up Omnibus SBA bill) partly because they felt that worker-owned small businesses provided an answer to the succession problem of small business people who want to see their independent tradition of entrepreneurship continued.

I believe this subcommittee should encourage the SBA to actively work with employee and worker-owned businesses as outlined in H.R. 3056 and S. 388 and Title 6 of the Omnibus SBA bill.

Fourth, ownership patterns generally within regions not just within firms merit our attention. In the chairman's own state of Iowa, David L. Barkley, formerly at the University of Redlands, California, has studied absentee ownership. He looked at the concentration of ownership in an area and demonstrated that branch plants are significantly less locationally stable than indigenous manufacturers. His study and findings in Iowa are convincing. He postulates that multiplant corporations should be able to survive a cyclical or secular downturn in sales given that they are able to realize certain economics that only large independent firms can realize, and that branch plants have a better ability than local firms to select capable managers and maintain easy access to financial markets. "However, the locational stability of branch plants still may be inferior to that of local manufacturers if their propensity for outmigration greatly exceeds that of indigenous firms. This inclination for branch plant migration during periods of depressed demand results from: (1) the ability of multiplant firms to increase production efficiency by consolidating production into fewer plants; (2) the ability of multiplant concerns to reduce overhead costs by closing branches and transferring production elsewhere; (3) the fact that indigenous firms are more likely to experience locational inertia than plants whose owners reside outside the community."

Controlling for product type, employment categories, and regional disparities (the western part of Iowa has a high transit cost), and, even with a lower bankruptcy rate than the indigenous firms, rural Iowa branch plants had 50 percent higher instability than independent manufacturers. Local ownership shows a greater ability, or desire, to withstand an unstable climate.

Mr. Chairman, I would be happy to provide the subcommittee with a copy of the Barkley study. [See Appendix P.]

As I have said before, my mind is not yet made up on the wide variety of anti-conglomerate legislative initiatives in the Congress. I can safely predict some of them will be debated for decades.

In the meantime, the worker-ownership provisions I have outlined, I think provided a modest and sometimes applicable approach to deal with the shutdowns caused in some instances by conglomerates.

Thank you.

Mr. Bedell. We also have on today's witness list representatives from the National Federation of Independent Business and the National Small Business Association, the two groups that are in forefront of representing the small business community's interest here in Washington.

We also have witnesses from the Progressive Alliance, a coalition of labor organizations.

Finally, we have as our last witness, Mr. James Wheat, president of Wheat First Securities in Richmond, Va. He is here testifying on behalf of the Securities Industry Association.

Our first panel will consist of John Motley of the National Federation of Independent Business and Tom Mauro of the National Small Business Association.

PANEL CONSISTING OF SMALL BUSINESS TRADE ASSOCIATION REPRESENTATIVES: JOHN MOTLEY III, TOM MAURO, AND EDISON ZAYAS

Mr. Bedell. Will you both please come forward with Mr. Zayas?

Gentlemen, will you please stand and raise your right hands as I administer the oath.

Do you promise that the testimony you give today is the truth, the whole truth, and nothing but the truth?

Mr. **Motley**. I do.
Mr. **Mauro**. I do.
Mr. **Zayas**. I do.
Mr. **Bedell**. Please proceed, Mr. Motley.

TESTIMONY OF JOHN J. MOTLEY III, DEPUTY DIRECTOR OF LEGISLATIVE AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; ACCOMPANIED BY EDISON R. ZAYAS, ECONOMIST

Mr. **Motley**. Thank you, Mr. Chairman.

First of all, let me say that the gentleman to my left is Edison Zayas who is a staff economist of the National Federation of Independent Business who has done a good deal of work on this testimony and some work in the area of conglomerate mergers for us. He will be available to answer questions later on, if you so desire.

I am also delighted on behalf of NFIB and myself that the committee initiated these hearings. It is something we believe needed to be looked at for some time. It was on our suggested list of hearing topics that was submitted to the committee back in the beginning of this Congress, and it is also something that is listed on NFIB's legislative priorities.

I thank the committee very much for taking a look into this area and hopefully something of benefit to small business will result from these hearings.

It is obvious to us, Mr. Chairman, that there is a great deal of merger activity taking place within the economy right now. Conglomerate mergers have been extremely vigorous since the passage of the Celler-Kefauver Act, but particularly over the last two decades. We believe this question needs to be looked at very carefully, but we do not believe that the focus should be one of big business versus small business, necessarily. It should be a focus of competition versus noncompetitive activities within the economy. We are very firm believers that so long as we have a truly competitive economy the small business community will indeed do very well for itself, but if those factors are allowed to get very far out of balance, then the small business community in this country will indeed be in trouble.

On behalf of NFIB's 600,000 small member firms, I am grateful to have this opportunity to express our views on the effects of conglomerate mergers and acquisitions of small businesses.

As representatives of small business, NFIB has an obvious interest in the potential impact of conglomerate mergers and acquisitions on the structure of our free market economy. In our view, it is highly important to maintain as objective a profile as possible in examining an issue that generates such a high degree of emotion from all interested parties. To be avoided at all costs, is the perception that this issue is one of big business. Instead, as I said earlier, our primary point of inquiry should be one that focuses on competitive balance versus competitive imbalance, for this is our genuine concern.

From the outset, we would like to make it clear that we do not know what precise impact the wave of mergers and acquisitions has had on small businesses. Evidence showing both the positive and negative aspects of mergers and acquisitions has been presented to this subcommittee. This lack of consensus disturbs us and we commend this subcommittee for attempting to get at the facts.

I turn now to the facts on mergers and acquisitions. In 1950, the Celler-Kefauver Act was passed into law amending Section 7 of the Clayton Act. This Act significantly strengthened merger law in that it covered vertical and conglomerate mergers, as well as horizontal mergers. Although time has proven that this Act has been effective in slowing the frequency of horizontal and vertical mergers, conglomerate mergers and acquisitions have actually increased in frequency and in relative importance.

According to a study prepared by Willard F. Mueller for the House Judiciary Committee, conglomerate mergers accounted for almost 72 percent of the total of large manufacturing and mining acquisitions during the period 1951 to 1977. Most of these conglomerate mergers were for product extension purposes, which are mergers between companies selling different products that are functionally related in production or distribution. Although the latter dominated conglomerate mergers in proportions, "pure" conglomerate mergers exhibited the greatest amount of growth in frequency. These pure conglomerate mergers are between companies that are unrelated in production and/or distribution. In the period 1951 to 1955, pure conglomerate mergers accounted for 44 percent of acquired assets. Consequently, the thrust of mergers and acquisitions since the enactment of the Celler-Kefauver Act have involved firms that were not closely related either in production or distribution.

Although these types of mergers do not have the immediate effect of increasing market concentration by industry, they have had the effect of increasing aggregate concentration across industries. In the period between 1950 and 1976, the largest 0.1 percent of manufacturing corporations increased their aggregate market share of total assets from 41 percent to 63 percent. The share of the largest 1.2 percent rose from 49 percent to 73 percent. According to Professor Mueller, conglomerate mergers have accounted for the bulk of this tremendous increase in the aggregate concentration of real and financial resources.

Given that in this time period the Supreme Court had developed a very strict set of rules regarding horizontal mergers, it became apparent to corporate management that horizontal mergers could be challenged. This had the effect of discouraging potential takeover attempts, as well as forcing divestitures. At the same time, however, it is clear that strict enforcement of the latter created a spillover of mergers and acquisitions in the form of conglomerate mergers, especially in the pure form.

I would like to go now to the effect of conglomerate mergers and acquisitions on small business.

Small businesses may be affected by these mergers and acquisitions in ways that could prove to be dangerous to their viability and growth potential. According to preliminary work being conducted by Prof. David Birch of the Massachusetts Institute of Technology, small- and medium-size firms acquired by conglomerates tend to display slower employment growth rates relative to their independent counterparts after acquisition. This is indicated in table 1 which I have submitted for the record.

Mr. **Bedell**. Without objection, the table referred to will be inserted in the record at this point.

[The table referred to follows:]

TABLE 1—AVERAGE ANNUAL PERCENT GROWTH OF U.S. ESTABLISHMENTS BY SIZE AND LEGAL STATUS, 1969–72 AND 1972–74

Size in 1969	Growth During— 1969–72	Growth During— 1972–74	Change in growth rate
Independents throughout:			
0 to 20	8.5	3.5	−5.0
21 to 50	.5	2.1	+1.6
51 to 100	−1.0	1.4	+2.4
101 to 500	−1.8	1.1	+2.9
500 plus	2.1	1.4	−.7
Establishments acquired during 1969–72:			
0 to 20	14.2	3.4	−10.8
21 to 50	2.1	3.6	+1.5
51 to 100	.5	2.2	+1.7
101 to 500	−.8	1.7	+2.5
500 plus	−8.3	−2.6	+5.7

Source: Prepared statement of David Birch before House Small Business Subcommittee on Antitrust and Restraint of Trade, February 12, 1980.

Mr. **Motley**. Since, according to Birch, small- and medium-size firms were acquired because of their previously rapid growth, the fact that they all grew slower after acquisition has strong policy implications given small business' predominance as a major employer. Interestingly, Birch's study showed that conglomerates sought to purchase large firms that were performing poorly and were able to improve their performance modestly. The importance of these findings is that mergers and acquisitions are not neutral in their impact on firms of different sizes. I refer here to a statement prepared for the House Small Business Subcommittee on Antitrust, MIT program on neighborhood and regional change, by David Birch, February 12, 1980.

In light of these findings, Prof. Yale Brozen's study showing the efficiency gains derived from mergers and acquisitions cannot be related to small businesses since he only examined the performance of acquired firms listed in the New York Stock Exchange. Here I refer to a publication by Yale Brozen, "Industrial Concentration and Public Policy," New York, MacMillan, which is forthcoming.

In instances where small businesses are not the explicit target of mergers or acquisitions, they may still be adversely affected by the nature of the competition they face when a competitor is acquired by a conglomerate. An acquired company will, through its affiliation with the conglomerate, have access to a vast network of financial and managerial resources that would otherwise be unavailable, or available at prohibitively higher costs.

Consequently, the competitive scales may be tipped in favor of the acquired company as a result of the merger, thus placing competing independently held firms at a competitive disadvantage. Therefore, these mergers may allow large conglomerates, by virtue of the size and diversity of their asset bases, to eliminate potential competitors and further expand the control of large corporations in specific industry markets. This phenomenon is commonly referred to as cross-subsidization, which need only mean an internal transfer of resources from one subsidiary to another, and not necessarily at a loss to a particular subsidiary.

This strong element of cross-subsidization tends to throw the premerger, competitive cost structure of an industry into a state of disequilibrium, that is, assuming there was equilibrium prior to a conglomerate merger—a reasonable assumption for most established industries. In most competitive industries, whether it is manufacturing, retailing, or services, the average costs of production tend to be similar among competing firms over the long run. In other words, competing firms in a mature industry tend to be operating at the industry's optimally minimum level of average costs, all things being equal—that is, barring technological innovations that lead to productivity gains in a given production process.

A conglomerate merger, however, allows the parent company to subsidize the operation of the acquired firm, thus effectively lowering the average costs of that firm, relative to the industry. The result is either entrenchment of the acquired firm in that industry, or an eventual increase in its market share of the industry.

One may argue that the latter result is procompetitive to the extent that the acquisition leads to lower costs and therefore to lower prices to the consuming public. However, it is vitally important to note that a decrease in average costs to an acquired company in this instance does not result from any technological efficiency gains per se, but rather from the effective subsidization of the acquired company's production process. This subsidization can take the form of reciprocity agreements among affiliated subsidiaries of the conglomerate, such as the providing of a free advertising campaign to the acquired company in order to achieve a greater degree of product differentiation.

For example, it is not atypical to find that after acquisition by a conglomerate, the newly acquired company engages in extensive television advertising. Television advertising is extremely costly and few companies can afford the expense.[1]

However, advertising on television is most effective, and as a matter of fact, a direct relationship between TV advertising and market concentration was found to exist in an econometric study covering the years 1947 through 1972. I refer here to a publication by Mueller and Rodgers, "The Role of Advertising in Changing Market Concentration," working paper 17, studies of the organization and control of the U.S. food system, University of Wisconsin at Madison. The same study indicated there was little or no relationship between concentration and other forms of advertising.

The implications of these findings are clearly self-evident. In this example, the acquired firm will, by virtue of its new affiliation with the conglomerate, be capable of gaining greater influence over its market. But the central point is that this influence is not gained through any increased economies, but rather through privileged access to resources not available to other firms. Clearly, the independently held small business would be hard pressed to compete successfully under these circumstances.

---

[1] Committee Note: See Appendix BB for an article by Samuel A. Smith, "Advertising and the Conglomerates."

I would like now to discuss the grocery retail business in this regard. A comprehensive exposition of examples showing the impact of conglomerate mergers on market concentration is beyond the scope of this testimony. For our purposes, we will limit ourselves to this one industry, the grocery retail business.

The grocery business is particularly appropriate, inasmuch as it is dominated in numbers by small businesses. As of 1972, there were approximately 172,000 grocery store businesses in the country, of which only 931 or 0.5 percent were multi-industry companies or conglomerates. Yet this 0.5 percent of the total industry accounted for almost 58 percent of the total amount of sales and receipts in the grocery store industry. This information comes from "Enterprise Statistics 1972—Part 1," Bureau of the Census, U.S. Department of Commerce. This static picture in itself indicates the tremendous market power commanded by a very few conglomerates. The dynamic picture indicates that conglomerate mergers have contributed to an increasing degree of concentration in the grocery retail industry.

A study prepared for the Joint Economic Committee in April 1977 examines the changes in concentration in 86 metropolitan markets between 1967 and 1975. I refer specifically to "The Profit and Price Performance of Leading Food Chains," by Marion, Mueller, Cotterill, Geithman, and Schmelzer, prepared for the Joint Economic Committee, Congress of the United States, 94th Congress, dated April 12, 1977.

The results of this study showed that when a large conglomerate chain, that is, a retail grocery chain with sales exceeding $500 million, entered a metropolitan market by acquiring a grocery retailer within the market, the market share of the top four chains in the market increased after the acquisition. This same study also found that a positive relationship existed between the number of large conglomerate chains in a market in 1967 and the change in the concentration between 1967 and 1975.

This latter finding supports the contention that, as the number of conglomerate chains increases in a local market, the market share of the top four retailers also increases. In addition, this study found that de novo entries do not always go hand-in-hand with a decrease in the degree of market concentration. Specifically, it was found that concentration increased when conglomerate grocery retailers entered de novo into low-to-moderately concentrated metropolitan markets in food retailing. The latter finding in particular demonstrates the competitive edge that is held by affiliated companies.

The results of this study are consistent with the FTC findings that substantial market extension mergers by large conglomerate food chains can lead to an increase in the market share controlled by the acquired retailers, due to the diverse powers of the acquiring chain. I refer here to the Federal Trade Commission findings in the National Tea Decision of 1966.

The point we wish to emphasize here is that market extension conglomerate mergers, as well as horizontal mergers appear to have an important impact on concentration in both local and national markets. To the extent that market extension mergers are not scrutinized by antitrust enforcement agencies, it becomes clear that the competitive environment for small, independently held businesses will become increasingly hostile and imbalanced.

I would like now, Mr. Chairman, to turn to some of the arguments in favor of mergers and acquisitions.

At this juncture, we would like to address ourselves to the arguments being used in opposition to stricter antitrust enforcement of conglomerate mergers.

The most common of these arguments is that conglomerate mergers promote efficiency gains in production and/or distribution, and therefore these mergers are desirable and beneficial to our economy. Those espousing this argument assume that increasing sales lead to automatic and proportionate increases in economies.

In the first place, this ignores the widely known findings emanating from industrial organization economics, that there is such a thing as a maximum plant size at which optimum efficiency is achieved. In other words, there is a point after which further expansion leads to diseconomies rather than economies. Here I refer to a publication by F. M. Scherer, "Firm Size, Market Structure, Opportunity, and the Output of Patented Inventions," from the American Economic Review of December 1965.

In the second place, if there is still room to achieve greater economies—in other words, optimum organizations/plant size has not yet been reached—the mergers should be among companies that are related in production and/or distribution—horizontal and vertical mergers.

"Pure" conglomerate mergers, which is what we are primarily concerned about, involve mergers among companies that are not related in production and/or distribution. If any economies are to be achieved through conglomerate mergers, they are marginal at best.

The primary motivation behind conglomerate mergers is not to achieve economies, but rather to diversify the asset base of the conglomerate in itself. This was explicitly stated in hearings before this subcommittee by Prof. Michael Gort of the State University of New York at Buffalo. Based on a study Professor Gort recently completed, he claimed unequivocally that firms diversify to escape from unfavorable industrywide growth trends, from unfavorable profit experiences, and from other limits to growth.

Therefore, the diversification of a large conglomerate's asset base—the number of companies it owns—serves merely to cushion the conglomerates from cyclical earnings fluctuations in selected industries. This, after all, is the whole purpose of a conglomerate. Ironically, if conglomerate diversification were carried to its ultimate extreme, we would end up with a very diversified economy consisting of a handful of conglomerates with an army of subsidiaries under their control.

One of the sources of these supposed efficiency gains emanates from the relationship between the parent company and the subsidiaries. In the words of Mr. Robert Hessen, research fellow at the Hoover Institution at Stanford University, who testified before this subcommittee:

> The parent company can often revitalize a smaller company by supplying it with money to improve or modernize its production methods, or it can introduce new techniques for quality and cost controls, or new incentive systems for workers and

managers, and generally provide assistance in the areas of production, advertising, marketing, and finance.

I am quoting here from the testimony of Robert Hessen's statement on conglomerate mergers and acquisitions before House Small Business Subcommittee on Antitrust and Restraint of Trade of February 12, 1980.

In defense of this practice, Mr. Hessen claimed that independent companies are not legally entitled to preserve the status quo or to prevent the introduction of new money or managerial methods into their industry. Mr. Hessen went on to say that independent companies must adapt themselves to the changes in the competitive market forces.

Although Mr. Hessen is quite correct on these latter points, he fails to address one major point. That is, why must an independent firm have to resort to a merger or a sellout in order to be able to obtain all of the financial or managerial resources only available as a subsidiary of a conglomerate? Are financing alternatives so limited to small firms that only through merging or selling out can they hope to raise the necessary capital?

If this is the case, maybe we shouldn't be concentrating on the merits of conglomerate mergers and acquisitions but rather in finding new ways to improve, for example, the financing alternatives available to small businesses.

Another commonly used argument is that mergers and acquisitions serve to promote corporate growth and technological progress. Certainly, this is true to an extent. This contention, however, rests on the assumption that all of our country's technological innovations have emanated from the laboratories of our large corporations. This assumption is at odds with all the available empirical evidence. The bulk of technological innovations witnessed in this country have, in fact, come from small- to medium-size companies, but mostly from small firms.

According to a study conducted by the National Science Foundation, in the period between 1953 and 1973, small firms produced about 23 times as many major innovations as large firms per R. & D. dollars spent, and nearly four times as many as medium-size firms per R. & D. dollar spent. Small firms also had a ratio of innovations to R. & D. employment four times greater than larger firms. Moreover, the total number of major innovations by small firms was greater than that by large- or medium-size firms.

Finally, the Office of Federal Procurement Policy's report on small firms and Federal R. & D. found that the total cost per scientist and engineer was almost twice as much in firms with over 1,000 employees than it was in firms with less than 1,000 employees. This information was taken from the Office of Federal Procurement Policy, Office of Management and Budget entitled "Small Firms and Federal Research and Development," a report by the interagency panel in 1977.

In the spirit of these findings, the NASA Administrator, Robert Frosch, announced in December 1978 that the agency planned on increasing research and development funds to small business by 40 percent in 1979. Thus to posit that mergers and acquisitions are a main source of technological innovations makes little sense in light of the facts.

Similarly, it is claimed that mergers and acquisitions significantly increase the marketability of small firms and therefore increase the demand for new, small firms. According to Professor Yale Brozen, the number of new firms founded or firms supplied—business formations—with additional capital to grow to middle size, will decrease with a reduced demand for firms as a result of reduced marketability. Consequently, says Professor Brozen, any limits placed on mergers and acquisitions could lead to reduced de novo entries.

Although the marketability of businesses is clearly one of the factors determining the demand for businesses—as it is with all assets—it is questionable that the potential for a merger or an acquisition is a significant factor in determining whether an individual will decide to go into business or not.

Stated differently, it is doubtful that mergers and acquisitions are dominant factors determining the demand schedule for firms. The demand for a firm is obviously a derived demand, for no one is really interested in the existence of a firm per se, but rather in what the firm produces. Thus, the demand for a firm primarily depends upon the existence and strength of the market for the product of the firm.

The increased marketability of businesses resulting from mergers and acquisitions is probably significant, but we would not overestimate its importance as a determinant of the aggregate supply and demand for firms.

Mr. Chairman, at this point I would like to also interject some of my personal observations. That is, that the demand for these types of firms may indeed be caused by the tax code and the way it treats mergers, especially mergers that are strictly exchanges of stock. I think, as we all know, if a larger firm wishes to buy out or purchase a smaller firm, the owner of that smaller firm can accept a tax-free exchange of stock. If he wanted to sell out to another small business man or to the offices of the company, he would have to do so for cash and, faced with the choice, he would be foolish not to choose the stock.

So, very likely it may be that some of this merger activity that we are seeing, especially where smaller firms are purchased by much larger ones, is being induced by the tax code. NFIB has been concerned about this for a number of years, and if the committee in its study finds that there is a serious problem here, we would suggest that you take a long, hard look at the effect of the tax code in this area.

We believe that it should be neutral and not necessarily favor conglomeration or merger. It is in the position today of favoring that. Certainly the small businessman who would accept cash for the sale of his business would be very foolish and would not be doing himself or his family or his heirs a service.

Finally, those espousing the virtues of conglomerate mergers and acquisitions claim that they help improve our balance of trade. Those holding this view contend that current antitrust laws have inhibited the growth of American companies, which have reduced their efficiency and therefore reduced their ability to compete in the world markets. This argument is based on the assumption that company size is the primary determinant of efficiency in production.

Although it is true that in many industries a very large level of output is required to achieve economies of scale, it is also true that diseconomies—relatively higher per unit costs—are realized beyond certain levels of optimum output.

Stated differently, it is possible to get too large and become less efficient as a result of excess production or an unduly large and complex organizational structure. Consequently, to argue that a more strict enforcement of antitrust laws affecting conglomerate mergers will hurt the competitiveness of American firms abroad ignores the economics of production.

Antitrust enforcement cannot be blamed for the growing inability of U.S. firms that compete abroad. The real causes of our balance of trade deficits lie in our inability to curtail domestic inflation relative to our trading partner countries, in our nonexistent energy policy, in the fact that most of our foreign competitors are either heavily subsidized or stateowned, in the overregulation of our businesses, and in the low levels of R. & D. on the part of our businesses. Moreover, since "pure" conglomerate mergers do little to promote economies of scale which can improve the competitiveness of our firms abroad, it makes even less sense to argue that closer scrutiny of conglomerate mergers will hurt our trade balance.

In sum, Mr. Chairman, we must address what appears to be an increasing amount of financial control by large conglomerates whose economic influence crosses industry lines. Our society is founded in a belief that excessive concentration—however defined—of political or economic power in the hands of a few is inherently dangerous and goes beyond our fundamental beliefs. Just as promerger spokesmen argue in favor of diversifying company performance, one should be equally concerned about maintaining economic diversity in an overall economy.

After all, it is this diversity which sets this country apart from the others, and it is this diversity which gives our economy strength and provides our people with the unique potential for the upward mobility we have witnessed and come to expect. One of the principal vehicles of this upward mobility lies in small business and the preservation of this mechanism is essential.

Mr. Chairman, we believe that there is still much to be learned about the effect conglomerate mergers and acquisitions have on our economy. We at NFIB recognize that there are beneficial aspects associated with conglomerate mergers and acquisitions, while also recognizing some of the inherent dangers involved for small businesses. We are encouraged by this subcommittee's interest and approach to this important matter, and we urge that objective research in this area be continued.

Thank you very much, Mr. Chairman. If we can answer any questions about our testimony or anything else you might have, we would be glad to.

Mr. **Bedell.** Thank you. We will go ahead with Mr. Mauro's statement, then we will have questions for both of you.

Please proceed, Mr. Mauro.

TESTIMONY OF THOMAS A. MAURO, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. **Mauro**. Thank you, Mr. Chairman.

I would first like to express Mr. Rothwell's regret at not being here today. He had planned to present this testimony but, unfortunately, he could not alter recent changes in his schedule. He asked me to come and present our testimony in his place.

I would like to make a correction in the testimony that we have submitted to the committee. I think this should be made a matter of record. We will submit this for the record, but I think it is important enough to make it a matter or record now.

Mr. **Bedell**. Without objection, your prepared statement will be inserted in the record in its entirety.

Mr. **Mauro**. Page 5 of the prepared testimony, the second sentence of the first full paragraph, should read "The economic ideal of efficiency, the demigod of economists, and claims relating thereto, rests on a rather circular reasoning." Therefore, please substitute the word "circular" for the word "circumstantial."

I will not repeat the testimony that we have submitted. Instead, I will attempt here to summarize the thrust of our testimony.

At the outset, the National Small Business Association does not advocate a ban on either bigness for itself, conglomerate or otherwise, or on mergers. Mergers can produce beneficial effects, and I think that is clear.

But we are concerned about the current wave of mergers, especially of conglomerate mergers and we do support the concept of strong and effective antimerger legislation.

In our view it is clear that ever-growing growth in size is not consistent with our country's national interests. In particular, we think there is a lot to be learned and a lot of facts to be discovered concerning the phenomena of conglomerate mergers. Congress has the resources and, indeed, is really the only suitable forum to accumulate and analyze these facts. Accordingly, we appreciate the hearings that this committee is holding on this subject.

I would like to turn briefly to the argument of efficiency which has been made by those in support of conglomerate merger activity. To some extent, I will be repeating the testimony of Mr. Motley, but I think it is a point that should be emphasized.

First, it seems to me that the efficiency arguments are an attempt to rewrite history. The antitrust laws were enacted to promote competition and opportunity for all. It seems clear to me and to NSB that the antitrust laws embody political and social aspirations as well as economic goals. This fact cannot be escaped and should not be avoided.

Mr. Justice Brandeis during his career was deeply interested in antitrust and the course of its enforcement. During his lifetime and his career he championed the cause of antitrust and therefore, we think of small business. In 1960, Prof. Milton Handler paraphrased his philosophy as follows:

> A political democracy such as ours presupposed a higher degree of economic equality. Without such equality, democratic institutions would not survive. Bigness in business was a menace to government. It compelled bigness in government to counteract the influences which concentrated economic power could exert. It stimulated the formation of big unions. It condemned most Americans to the servient status of employee rather than the adventurous role of entrepreneur.

It seems to me that Congress has not changed this policy and that we ought not to ignore it when considering legislation on merger activity.

Second, the efficency argument assumes that a company has the right to acquire whatever property it chooses regardless of the impact of such acquisitions on society. I think it is clear that the law should not assume that a merger must be examined purely on technical, economic grounds. Rather, mergers must be analyzed in view of the social impact they make on society as well.

Finally, Mr. Chairman, I would like to emphasize a point which I think follows logically from the points that I have just made.

There are noneconomic effects of conglomerate mergers. Any analysis of future antitrust enforcement must look beyond the competitive impact and into the social and political implications of the concentration of political assets in the hands of a few dozen or a hundred corporations.

To some extent since the passage of the Celler-Kefauver Act, the courts, expecially the lower courts, have ignored this idea or have held that such an analysis is beyond the scope of the Clayton Act. Therefore, I think your committee should give careful consideration to legislation which would incorporate such analyses into Clayton Act merger cases.

I have no further comments at this time, Mr. Chairman. I would be happy to answer any questions you may have.

Mr. Bedell. Thank you.

[Messrs. Rothwell and Mauro's prepared statement follows:]

Prepared Statement of Thomas A. Rothwell and Thomas A. Mauro, National Small Business Association

Mr. Chairman and members of the committee; my name is Thomas Mauro and I am appreciative of the opportunity to testify before this subcommittee. I am here today on behalf of the National Small Business Association and my colleague, Thomas A. Rothwell. The National Small Business Association (NSB) is a multi-industry trade association representing approximately 50,000 small business firms nationwide. Mr. Rothwell serves as antitrust and trade regulation counsel to NSB and deeply regrets that he could not alter previously arranged commitments to be here today to present this testimony.

We commend the committee for these hearings on the question of conglomerate mergers and their effects on local communities and small business. Coming as they do in the midst of yet another wave of mergers, these hearings are timely and, in our view, very necessary. Indeed, it appears that they have already produced a valuable and thoughtful record. There is no doubt that the small business community is extremely concerned about the apparently ever-growing acquisitive ambitions and motivations of large corporations.

The business of the United States is, in fact, small business. Of the 11 million non-farm business establishments, 10.7 million are small enterprises, as determined by the Federal government's size standards, and they account for as much as 58% of private sector employment and 43% of the gross national product. Economic studies—notably one by the Massachusetts Institute of Technology for the period 1969 to 1976—show that small businesses generate far more growth in employment than do big companies. And, as President Carter pointed out in his message to Congress on lagging innovation in the United States, it is small business that supplies "the majority of the new innovations in our economy."

These achievements have occurred despite the fact that large corporations are increasing their share of the economic pie and that small business owners feel they have little power in Washington, as their problems go unnoticed in the public forum in favor of the concerns of the nation's largest corporations. They are now becoming increasingly restless over what they feel to be too great a tilt in both economic policy and government regulation toward the interests of big business. Confirmation of this appears in an analysis of the concerns of small business owners in New York, based on a recent survey which Louis Harris & Associates, Inc., conducted for Chemical Bank.[1]

It is surely more than appropriate that the small business community should suggest some points of view and make known its interest in respect to the highly controversial subject of conglomerates and their pattern of consistent and persistent acquisitions. The description of a firm in the *Wall Street Journal* or other business periodicals as being "acquisition-minded," has become both trite and commonplace. And there can be little doubt that our panoply of antitrust and trade regulation laws and standards, and the enforcement thereof, is at this point insufficiently sophisticated and quite inadequate to cope with this genre of a problem that impacts in many subtle ways on our day-to-day life. We applaud this Committee for the foresight and even courage it takes to come to grips with such a complex and most profound area.

Starting with the premise that it is the competitive process and the functioning thereof that is vital to our economic structure—that we have as a nation a fundamental and enduring commitment to a system of private enterprise that is both free and competitive—certain corollaries to this premise become obvious. One such is that for competition to exist and flourish, a plurality of competitors is required. Stated another way, it is obvious that any market structure approaching monopoly is the direct antithesis of a competitive system. This is both theoretically unassailable and capable of pragmatic, real-world proof. Such antitrust monopoly cases as *United States* v. *Standard Oil* and *United States* v. *United Shoe Machinery Corporation* carry out Congressional policy and are quite dispositive of the question.

Of course, the immediate question that arises is just what is the critical number? How many competitors are needed in a particular market so as to ensure the effective presence of competition? How few can the number of firms become before the industry starts to behave in a monopolistic fashion? To resolve this question the courts look in a technical sense and on an ad hoc basis at each merger and each market. Such arcane subjects as price signalling, conscious parallelism, oligopoly, market entry barriers, technology transfers and a number of other economic phenomena have thus been employed in passing on any given merger.

Classic economic theory holds that competition is critically impaired when a business decision by any one firm has a discernable impact in the marketplace. If this be the standard, then it is evident the competitive process has to some extent been curtailed or even eliminated in certain of our major industries. Automotive, steel and oil come readily to mind as examples of this. More signficant, however, is the fact that it is from percisely this genre of business and industry that the conglomerate phenomena emerges. Monopolistic or oligopolistic industries are rarely the target of conglomerate entry. Rather, such industries spawn conglomerates. Whether this is the product of shared-monopoly profits or not would make for a most interesting and even more complex inquiry. However, an identification of the causative factors and conditions from which conglomerates emerge is not the focus of today's hearings. Rather the pointed inquiry is: What happens to small business when the conglomerate phenomena appears in its industry? There is, however, a certain overlap between these two subjects.

One important and perhaps significant example of this overlap is the nature of the justification offered for the wave of conglomerate activity we have been experiencing. The "buzz-word" here is efficiency. It is urged that conglomerate acquisitions occur as a result of efficiency, and that they bring this unique virtue to the industry in which the acquisition is being made. And who, they ask, can possibly be opposed to efficiency?

At the outset it is significant that no empirical data is offered by economists or others to support claims of superior efficiency in a conglomerate merger. The economic ideal of efficiency, the demi-god of economists, and claims relating thereto, rests on rather circular reasoning. A firm is big, they say, because of economies of scale; its bigness proves this. If such a firm were relatively inefficient in its industry, it would not grow. It has grown, therefore it must be efficient. Its bigness, in turn, justifies its acquisitive ambitions. So goes the argument.

It is suggested that a review of Judge Learned Hand's classic decision in the *Alcoa* case be reviewed with care. Alcoa, a giant among pygmies, was offered the opportunity to demonstrate—to prove—that their size was the result of superior "foresight, industry and skill." Such proof was not forthcoming—quite palpably, it did not exist. Additionally, it should be noted that efficiency has been the defense and justification for monopoly, and the apologists therefore, for over a hundred years.

---

[1] *Looking Toward the 80's*: A Chemical Bank Survey of Small and Medium Sized Businesses in New York (November 1979).

The so called muckrakers of the 19th century exposed the fallacy of such claims, but they continue to be made.

Finally, it may well be folly to accept the economic ideal of efficiency as paramount, a value to which all others are subordinate. In our political life we prefer inefficient democracy to well-organized fascism. We have learned to fear power as such—too much power in too few hands. And, as one President put the matter, political democracy is meaningless when accompanied by economic autocracy.

It is understandable, perhaps, that without Congressional direction courts are drawn to the safety and security of decisions wrapped in the cloak of an expert economist's apparently scientific logic, especially when those decisions carry the massive economic impact typically connected with an antitrust case. It has been thirty years since Congress expressed in the Celler-Kefauver Act its concern with the dangers of corporate concentration. Bolstered by the passage to time and recent adverse Supreme Court rulings, we have seen in these hearings that increasing concentration of economic power continues unabated, primarily through merger activity. Moreover, it is clear that such concentration remains a major obstacle to the creation of an economic climate in which small business can survive and thrive.[3]

Nor is it surprising, given current national financial policy, that business growth via the conglomerate route has become most fashionable. Tax and security policy that permit capital to be retained or raised for conglomerate ventures provide a hospitable environment for such ventures. And, from the point of view of the conglomerate enterprise, it spreads the risk. Their eggs are not all in one basket, so as to speak. This contrasts sharply with the small business situation. Typically a small business will thrive or fail based on its profit or loss experience in one industry only.

The deep pocket advantage of the typical conglomerate, plus its ready access to institutional financing via the nation's banks and securities markets, constitutes an obvious and correlative disadvantage as to the smalls. Add to this such matters as more and better advertising at the beck and call of the properties of a conglomerate, market pricing strategies that come down to an ability to "buy" a desired market share, and the bottom line may be described in terms of market entry disadvantages or barriers as to existing or potential small competitors in a given industry.

A few years ago a situation occurred in California involving independent bakers. The bigs—conglomerate entities in some instances—moved in and by below-cost pricing "bought" market shares. The independents sued and collected, but did not reopen their independent businesses. To this day, there is no business opportunity for small entrepreneurs in that market.

While a technical and even scientific analysis of the degree of concentration in an industry and the measurable competitive impact of a proposed merger may be necessary under the Clayton Act, especially with respect to conglomerate mergers, it should not be the only analysis. It is becoming painfully apparent that there are adverse, non-competitive, economic impacts as well. And in our view, this reflects the most ominous aspect of the growing influence of conglomerate power and the corresponding breakdown of effective antitrust enforcement, the absence of any countervailing power whatsoever.

We have seen in the study by Professors Bluestone and Harrison, introduced before this Committee, that a conglomerate plant closing may well be the result of a planned strategy to increase profits, the impact of which goes well beyond the immediate and corresponding loss of jobs. Older facilities may be allowed to become run down, worn out machinery not replaced, lives and careers disrupted, skilled labor and reinvestment lost to the affected communities and shifted to new facilities located in some other city, state or country—all not for any greater societal advantage, but merely to exploit the cash-generating function of the conglomerate. We have seen this increased political power commensurate with their economic power used clandestinely through bribes and kickback schemes and openly through thinly-veiled threats to close plants unless a particular conglomerate goal is permitted by the government.

It seems clear then that there are adverse effects of conglomerate mergers that cannot be counterbalanced by efficiency arguments which purportedly favor a less vigorous antitrust enforcement policy. Indeed, an antitrust economic policy favoring smaller businesses in preference to giant conglomerates may well be consistent with economic efficiency goals. Thus, it has been recently suggested:

Some have argued that consideration of these political objectives is improper, because preservation of the assumedly inefficient small companies must be at the expense of the consumer, who will pay higher prices reflecting the higher costs of small businesses operating at less than full economies of scale. However, it is equally plausible that encouraging additional centers of economic decision-making will both spur innovation and make more difficult express or tacit collusion, with a resultant lowering of prices and increase in volume of production—the very goal of scholars taking a purely economic approach to antitrust.[9]

---

[3] We refer this Committee to the testimony of the National Small Business Association during the Hearings on Merger Legislation, Senate Committee on the Judiciary, March 28, 1979 and to the House Small Business Committee's report entitled "Future of Small Business in America".

Because of the nature of this inquiry, NSB has confined its comments to those of general impact. But our goal is simply stated: smaller businesses need an effective national merger policy developed and carried out to restore competitive balance. That policy must produce substantially greater growth for small and medium-sized businesses than for big business and big government. Particularly in the area of conglomerate merger activity, the natural checks and balances upon which small business depends to survive and to prosper have been all but eliminated. The antitrust laws, despite their intent, have not worked to achieve their purposes.

In closing, we again commend the Committee for raising these important and timely issues. We are pleased that you have allowed us to prevent our views and look forward to your continued development of these questions.

Mr. **Bedell.** Mr. Tauke?

Mr. **Tauke.** Thank you, Mr. Chairman.

During the time that we have spent on these hearings, I think a couple of things have become relatively clear. First of all, I think most of the members of the subcommittee would agree that we have found that the conglomerate mergers are not the greatest things since sliced bread.

Second, we have also learned that conglomerate mergers are not in themselves inherently evil.

Consequently, as we reach this point in the hearings, it seems to me that, first of all, we have to decide if conglomerate mergers are occurring in circumstances where they should not occur.

Second, we need to know if Government policies are encouraging mergers in circumstances where they should not occur.

Third, we need to know what we ought to do about that, if we do indeed have that problem.

I take it from your testimony that you are assuming that mergers are occurring in places where they should not occur. I think you are also suggesting that Government policies are in part the cause of that. Let me examine that a bit.

Mr. Motley, you suggested that we had financing problems for small business. On page 8 of your testimony you asked a question "Are financing alternatives so limited to small firms that only through merging or selling out can they hope to raise the necessary capital"? In a sense your question is begging for an answer of "yes," but I wonder if you would like to answer that question for us?

Mr. **Motley.** I would like to try to. I think it was very obvious and very plain from the recently concluded White House Conference on Small Business that the delegates that were elected to participate thought that capital formation was the overriding problem facing the small business community today. In effect what that paragraph in my prepared statement says is that it is an extension of this problem.

One of the alternatives which is available to a small firm that wants to grow and cannot raise the capital by other means, either through debt or equity or going to the insurance companies, or whatever it might be, or into the public money markets, is to sell out or merge with a larger corporation and have that corporation provide the financial resources.

---

[9] Bauer, *Challenging Conglomerate Mergers Under Section 7 of the Clayton Act: Today's Law and Tomorrow's Legislation,* 58 Boston U.L. Rev. 199, 235 (1978) (citations omitted).

It can tap into the market that the smaller firm cannot. I think it is very well documented both by subcommittees of this committee and subcommittees of the Senate Committee on Small Business that there are tremendous difficulties that small- and medium-size firms have in raising the capital if they want to grow.

This is simply one of the alternatives. We think to a certain extent it may be an unnatural alternative or that Government policy is funneling these firms toward this alternative rather than otherwise.

Mr. TAUKE. What Government policies are funneling the firms toward this alternative? I know you mentioned the tax policy and the tax code. Are there any others? Maybe you want to elaborate on the tax code situation.

Mr. MOTLEY. It would probably take a great deal of time to begin to elaborate on the tax code itself. I think that the tax code definitely does not allow a small firm to retain enough of its profits in order to allow it to grow if it so chooses to grow, whether that firm be a corporation or whether it be a proprietorship or whether it be a partnership.

In effect certain tax policies of the Federal Government, especially payroll taxes, may actually operate in the other direction. This would inhibit a firm's growth especially during its first 4 or 5 years.

We also know that out of every 10 firms that come into existence in this country at least 5 of them fail within the first 3 to 4 years.

You run into a situation like this. Let's take a small retailer who wishes to grow. He sets himself up in business. He goes out and he purchases inventory. He hires three or four people. He ends up having to go to the bank at 20-percent interest rates, roughly right now, to borrow the money to pay his withholding taxes so he can deposit it for the Federal Government. He might do it on a weekly or monthly or quarterly basis. He has to go to the bank in order to finance the increase to pay his taxes on the cost of the inflationary increase of the cost of his inventories. He has not gained any money at all. He hasn't sold the product. All he has done is that he has gone out and purchased his inventory.

This is just one example, but there are hundreds of examples throughout the tax code. Accumulated earnings tax is another one. A firm accumulates $100,000 or $150,000 within the corporation because it wants to grow, and IRS comes along and says that is an unnecessary accumulation and imposes a penalty of accumulated earnings tax on it because the Government thinks the corporation is trying to shelter the money in not giving the money out in dividends to its investors.

I am terribly familiar with the problems in the securities industry area. There will be a witness here later on today who very likely could get into that, but it is my understanding, especially from the work that has been done by the Senate counterpart of this committee, that the problems that have existed in the securities industry have actually prohibited the offerings of stocks in small companies over the last decade. As a matter of fact, it is almost to the point where it became nonexistent 2 or 3 years ago.

Therefore, these are the types of Government policies that may be forcing smaller firms to go the merger route in order to raise the money that is necessary to finance a new product line or to finance the growth of the business.

Mr. **Tauke**. During the course of these hearings we have had a lot of people tell us that mergers are not so great. We have had a lot of case histories of the problems that occurred because of mergers.

We have not had much testimony that really deals with the question of what the Government policies are that encourage mergers. I am talking about mergers that theoretically should not otherwise occur.

I wonder if perhaps your organization might be in a position to look at that question a little more closely. How about looking a little more closely at the tax code and submit to the subcommittee at a later time additional testimony, which would relate to the questions of what Government policies actually cause or encourage mergers that should not, because of market forces, take place.

Mr. **Motley**. We would be delighted to take a look at that question and get back to the committee at some future date.

Mr. **Bedell**. The chairman has a strong belief in this area. I think the top 400 corporations have $80 billion in cash on hand according to a recent study.

Mr. **Motley**. When the Tax Reform Act of 1978 passed it was $88 billion, so it is probably a little higher than that.

Mr. **Bedell**. I am referring to cash assets.

Mr. **Motley**. Yes.

Mr. **Bedell**. If you are going to change the laws so there is a greater opportunity for capital formation, then instead of $88 billion, it is going to be $100 or $120 billion.

As long as those large corporations have all that cash sitting in their coffers, they are going to be buying more and more of the middle- and small-sized businesses.

I would hope that when you look at what we ought to do for small businesses, you will recognize what seems to be happening very clearly in all the testimony we have had and all the information I have been able to obtain. Big business is taking over more and more of our total business activity in this society.

We had a witness testify that 80 percent of the manufacturing assets of the United States were now owned by the 400 largest corporations. So, I hope that we are not just looking at Band-Aids. I hope we are looking at what the real problem is. I think the real problem is that the big fish are getting bigger and bigger and there are fewer small fish, and we are going to end up with nothing but big fish in our pond. That is as clear as I can see it if present policies continue.

Therefore, I hope that as you look at ways to help the small fish to survive you are not just looking at ways to help them survive so that they can be food for the bigger fish. I think that is what the tendency in the area of capital formation may be.

I thank the gentleman for yielding.

Mr. **Tauke**. That is pertinent, Mr. Chairman. It gets into the question that Mr. Motley raised relating to the tax code and the transfer of shares of stock.

Let me conclude my questioning by asking both of our witnesses if, in addition to the general comments relating to taxation and capital formation and some of these other things, we got rid of those bad Government policies, are there new things that ought to be done in the antitrust area, for example, to restrict or in some way deter the formation of large conglomerates.

Mr. ZAYAS. Related to that, let me say this. It might behoove us to take a look at the current antitrust laws and the way they treat vertical and horizontal mergers.

It appears there may be a possibility that with the way that we have placed such perhaps overly strict and perhaps economically nonrational approaches to vertical and horizontal mergers that we have created a spillover effect in a sense forcing large conglomerates and large businesses to look across industry lines into other areas in order to try to cushion their asset base so they can protect themselves from unfavorable industrywide trends.

This is an area that I have not looked at, but perhaps it should be looked at. We should look maybe at whether the current antitrust laws as they exist right now are actually encouraging across-industry-line takeovers which do not seem to have any economic rationale.

Mr. TAUKE. Have you done any study of that?

Mr. ZAYAS. No; I have not. A witness before this committee glossed over it. I believe it was Robert Hessen of Stanford University. He did not touch on it at all. He just went across it lightly. It brought the idea to my mind. It is an area that really should be looked at.

Mr. TAUKE. Is there any group or organization or university or scholar that you are aware of that is looking at this?

Mr. ZAYAS. No, sir.

Mr. MAURO. I would like to comment briefly on that. The antitrust laws seem to be ineffective when applied against conglomerate mergers because the mergers often take place between different industries and different markets.

With respect to these types of mergers, antitrust policies should be made clear. If that requires a change in the law or a change in the merger provisions of the law, then the law should be changed to reflect the policies of the Clayton and Sherman Acts.

The courts seem to be taking a very technical approach when they analyze mergers. If you can come up with what seems to be very sophisticated and scientific testimony that the merger will create more efficiency, then the courts will probably let the merger proceed.

I think that the law should do more than just require that these kinds of analyses be made. I think that as long as there are big companies out there with a lot of money available that they will simply acquire property because the property is there.

Mr. MOTLEY. When I mentioned the tax code, we mentioned that in a way that makes it end up beneficial for a lot of small business people who want to get out and get rid of their businesses.

However, we have also been very concerned about the much broader question of how the entire code impacts upon the rationale for mergers. A couple of years ago the head of our research department tried to get a study going in that particular area and wanted to go out and find someone with the expertise to do the study. We found out that it was extremely difficult because they were all working for the major corporations who were doing the mergers.

I am not versed enough to get into the specifics on this, but it seems to me that in talking to some of the people that we know in this particular area that there are also very significant tax advantages to some of the conglomerates in this area which are buying out all the firms and they are using their assets and their depreciation and their investment tax credit, and so on, to help their bottom line picture rather than going out and investing the money in new plant and equipment and taking a chance.

It is a whole area that really is quite fascinating and needs to be looked into, but we have very few people, as I said, either in the public sector or in the small business sector who have the expertise to look at it.

Mr. **Bedell.** If the gentleman will yield, let me say this. The Federal Trade Commission made a study of this about 3 years ago when I was on this same subcommittee.

At that time their conclusion was that large business paid a smaller percentage of income tax than small businesses. That is only one of the advantages that exists. You can go down the list. Large corporations borrow money at lower interest rates. They can acquire capital through the stock market which is not available to smaller businesses. They have advertising economies because of national distributions. Right on down the list they have advantages.

As some of you know, I have been one of those people who have said for a long time that we needed a truly progressive corporate income tax so that the advantages that are going to big businesses go to small businesses. The White House Conference on Small Business went a tiny, tiny way in that. I think the trouble is that everyone looks at their own situation and how they survive instead of what the real problem is.

I think the Conference wanted to increase it to $500,000 in terms of the maximum corporate income tax.

Mr. **Motley.** I see you had your bill introduced again this year.

Mr. **Bedell.** Yes, and it will get about as far as my bill limiting terms of Congressmen will, I suppose. There is not much excitement over it. I feel we should somehow start looking at what the problems are in regard to our total corporate activity. Nobody disputes what is happening. It is very clear what is happening.

Mr. **Motley.** The chairman's bill for graduated corporate income tax was the only one which was at all close to the recommendations of the White House Conference on Small Business. They did not graduate it beyond the 46 percent like you do, but the $500,000 cutoff level that you both use is the only one that is consistent with that.

Mr. **Bedell.** I thank the gentleman for yielding.

Mr. **Tauke.** I want to thank these gentlemen, Mr. Chairman. I think that if we have additional hearings they have given us plenty of things to talk about.

Mr. **Bedell.** Mr. Gonzalez?

Mr. **Gonzalez.** Thank you, Mr. Chairman. I have no questions.

Mr. **Bedell.** I have a couple of remarks. First of all, Mr. Motley, I think there should be a correction in your statement. On page 7 you say "This was explicitly stated in hearings before this subcommittee by Prof. Michael Gort of the State University of New York at Buffalo." I don't think it was before this subcommittee. I think it was before the Senate Judiciary Committee. Would you change that?

Mr. **Motley.** Yes, sir. That is correct.

Mr. **Bedell.** Mr. Motley, you indicated that you thought part of the problem is the laws which now permit tax-free exchange of stock. Do you have any idea whether your members would be supportive of a change in that area?

Mr. **Motley.** It would be an interesting question to pose to them. I do not think we have asked that in exactly that way. The approach of most of the small business groups is, as you know, that they support the concept of a rollover which would, in effect, neutralize the part of the code which today encourages smaller firms to sell out to larger ones for tax-free exchange.

Mr. **Bedell.** I don't know what you mean by rollover. Please explain.

Mr. **Motley.** It is a bill which has been introduced by the chairman of the committee, the full committee, and also by the chairman of the Senate Small Business Committee and several others, which, in effect, would, if a small business person were to sell out for cash or for something else rather than for stock in a major corporation, and he reinvested that money within the following 18 months in another qualified small business, then it would be an option available to him and he would not pay the capital gains taxes. It would give him the same treatment as if he were to sell out for stock to a major corporation. It would neutralize the tax effects.

Mr. **Bedell.** I do not think it would. If you are a small business person and you want to sell your business and retire, you have the choice of selling to other investors for cash and paying the full income tax on that sale. You are not going to invest in another small business. Or you could sell to a big business on a tax-free stock exchange. So, I don't see how that solves the problem you are talking about.

Mr. **Motley.** We would probably tend to agree with the chairman on that. The type of behavior you are talking about as far as reinvestment is concerned is atypical. When a small business person does wish to get out of the business that he or she has successfully created over the years, they want to get out altogether. They generally do not want to reinvest their money in other small businesses.

There are people who believe, however, that if this section were put into the code that some of them would change their behavioral patterns and it would cut down on the number of mergers that are occurring.

Mr. **Bedell.** My opinion is that the number cut down would be a very few.

Mr. **Motley.** The accountants would agree with you. It is the economists that may be espousing the other theory.

Mr. **Bedell.** We have great confidence in our economists after what has been happening in the last year or two with regard to inflation. [Laughter.]

Is this something you might find out from your members?

Mr. **Motley.** If the chairman would like, we could poll our members at a later date.

Mr. **Bedell.** It would be of interest to us. I have a feeling your members might not be as excited as you think about removing that opportunity to dispose of a business with a tax-free exchange of stock.

Mr. **Motley.** They may not be.

Mr. **Bedell.** It would be a good thing for us to find out.

Mr. **Motley.** We have not espoused the removal of the opportunity. What we are saying is that it exists and it obviously has some effect upon the behavior of business people who want to get out of the business and move on to something else.

There may be other alternatives that are possible.

Mr. **Bedell.** We have talked about capital formation and accelerated depreciation. If we were only to allow accelerated depreciation in those cases where the accelerated depreciation credit was used for replacement within the same business entity from which the depreciation was allowed. You could not simply take your accelerated depreciation and buy some other firm with it. Do you have any idea whether that would work?

The problem I have is this. Currently large corporations take the capital we let them form and go out and buy all these other businesses. This is clear in the steel industry. They are not reinvesting and updating their steel facilities. They are buying other businesses rather than reinvesting in steel.

Do you have any idea whether that would work or not?

Mr. **Motley.** No, I don't, Mr. Chairman.

Mr. **Mauro.** I do not have any idea as to what our members would think about that, but it seems to me that if you are running a small business and if you had the opportunity to generate more capital, then you will apply that capital to the small business. It is not United States Steel, of course. It would not look around for things to buy. It will look for ways to improve its own business. That is my off the top of my head reaction to your point, Mr. Chairman.

Mr. **Motley.** I think you would have to take a very careful look. So often when we change one thing in the tax code we induce behavior that we really did not want to induce in the first place. It is like throwing a stone into a pond and watch it ripple.

I have no idea what the effects would be. I think that we should take a real hard and long look at it to see if it is a possibility or whether it would cause damage.

Mr. **Bedell.** That is part of our problem. Following up on Mr. Tauke's question, people come before us with the problems, and we ask you what we should do, and your answer is that you don't know.

Mr. **Motley.** We really don't. That is true.

Mr. **Bedell.** I think we need to have some answers.

Mr. **Motley.** It is a problem. We recognize it, but we have not been able to come up with decent workable solutions.

Mr. **Bedell**. Well, we thank you all for being here.

[See Appendix S for additional material submitted for the record by Mr. Mauro.]

Mr. **Bedell**. Our next panel consists of Mr. Dan Marschall, director of Citizen's Action, and Ms. Barbara Richards, Community-Labor Alliance in New Haven.

PANEL REPRESENTING THE PROGRESSIVE ALLIANCE: BARBARA E. RICHARDS AND DANIEL J. MARSCHALL

Mr. **Bedell**. Would those two witnesses please come forward.

Will you please stand and raise your right hand while I administer the oath.

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth?

Mr. **Marschall**. I do.

Ms. **Richards**. I do.

Mr. **Bedell**. Ms. Richards, please proceed.

TESTIMONY OF BARBARA E. RICHARDS, EXECUTIVE DIRECTOR, COMMUNITY-LABOR ALLIANCE, NEW HAVEN, CONN.

Ms. **Richards**. I want to thank you for the invitation to testify on behalf of the Progressive Alliance. I am Barbara Richards, the executive director of the Community-Labor Alliance in New Haven. The CLA is a coalition of 37 local organizations, including 13 union locals, and community agencies, neighborhood groups and block associations, churches and community economic development corporations.

I have also been an assistant professor at the School of Organization and Management at Yale University, and a member of the New Haven Board of Aldermen, so I have had the opportunity to view the problem considered here—the effect of conglomerate mergers on local communities—from a number of different perspectives.

This statement will draw heavily on the testimony previously given before this subcommittee by Barry Bluestone and Bennett Harrison on February 12, 1980. They have done an excellent job at presenting the technical information and research data which overwhelmingly demonstrate the destructive impact on local communities caused by the movement of capital based solely on criteria of profit maximization.

What I will attempt to do is to build from the information they have presented, a case study of one typical New England city, to give the committee a sense of the small-scale local devastation which results from the national and regional trends they describe.

Please bear in mind in the discussion that follows that New Haven is a very small city, with only 130,000 residents, heavily dependent on its historical economic base of manufacturing. With such a small population, any major layoff or closing in the manufacturing sector causes massive repercussions in the entire community.

I turn now to the subject of costs of social mobility as illustrated by Bluestone and Harrison. They point out—pages 4 and 5—that most estimates of plant shutdowns are based on actual closings of plants with immediate relocation, but that in fact it is very common for more subtle forms of shutdown to erode the stability of communities. These include gradual shifts of jobs and machinery from older to newer facilities of the same company; running down of older facilities by not reinvesting profits made locally to modernize; siphoning off profits of a subsidiary to the parent firm for reallocation according to other priorities.

In New Haven, one of the most tragic cases of capital mobility is not technically a shutdown as of this date. The Winchester Corp., manufacturer of fine sporting rifles, was founded in New Haven in 1870. By 1944 it employed 7,137 people. In 1954 it was bought by the Olin Corp. The Winchester Division accounts for only 19 percent of the business of this large corporation which is not headquartered in New Haven.

In 1969, the union at Winchester, local 609 of the International Association of Machinists, had 4,500 people in its bargaining unit.

In 1972, the Olin Corp. began threatening to leave the city. It has never announced a decision to leave, but began letting the facilities run down and gradually transferring aspects of production elsewhere. By the summer of 1979, when local 609 went on strike, it had only 1,350 members in the bargaining unit—only 30 percent of its size a decade before.

During the strike, the company announced that it was moving the brass mill, at a cost of 150 more jobs. At the same time, they quietly moved other machinery as well, so that when the strike was settled, the union was told that only 550 people would be returning to work.

For all intents and purposes, Olin has left New Haven. It has done so not because of a lack of profits, which the company has announced were adequate in the past year. It has done so by way of corporate decisionmaking outside of the city, which led to an allocation of only $11 million in capital funds for the Winchester facility since 1976.

Richard D. Wolff, professor of economics at the University of Massachusetts and resident of New Haven, explained the significance of this figure in a letter to the New Haven Board of Aldermen, dated November 14, 1979:

> Olin's 1977–81 capital spending budget is set at $1 billion. Winchester accounts for 19 percent of Olin business and might hence be expected to obtain roughly 19 percent of the capital spending allocation, or $190 million, of which a major portion would be spent in and for the New Haven facility. This expectation would be reasonable if Winchester were slated to maintain its relative position within the Olin Corp., and likewise its New Haven facility. Since the latter received a mere $11 million so far, and no further capital spending is presently committed, it is manifestly clear that Olin's capital spending program does not include any significant expansion in New Haven. Indeed, this review of available data suggest that merely the maintenance of the New Haven facility is highly questionable.

The Winchester works sprawl through 67 acres of one neighborhood of New Haven, and it is not surprising that over the 10 years of gradual layoffs, the neighborhood has deteriorated dramatically. Stable streets of neat houses, primarily owner-occupied, and small commercial mom and pop stores, have become plagued with housing abandonment, fires, high crime rates, and serious problems of alcohol and drug abuse. In addition to the impact on the neighborhood, there is a direct impact of the loss of $15 million to other business firms that provide Winchester with materials such as oil, dyes, packaging, et cetera. This information was taken from the New Haven Journal-Courier, December 27, 1979.

Olin-Winchester was until very recently the largest manufacturing establishment in the city of New Haven. The destructive effects of the loss of almost 4,000 union jobs plus the managerial and supervisory jobs accompanying them, over a 10-year period, can hardly be overstated. Yet this case appears in no statistics on plant shutdowns.

Bluestone and Harrison state that large conglomerate mergers sometimes close profitable branch plants, either because they require certain target profit levels from all subsidiaries, or for other reasons which don't consider the jobs of local workers. They also state that unfamiliarity with the operations of a local company by remote management may cause unprofitability.

In New Haven, over 600 workers at the Gant Corp. read in the local newspaper one Saturday this past spring that their plant was to be shut down with the first layoffs occurring the following Wednesday. Gant grew out of a firm which had been founded in the 1930's by two brothers who had a falling out and established separate firms—Sero and Gant, both shirtmakers—in the early 1940's.

The differential histories of these two firms are very interesting from the point of view of the deliberations of this subcommittee. Gant was sold to Consolidated Foods, a large conglomerate with 50 to 60 companies, in 1968. It was then resold to Palm Beach, Inc., which, as a condition of the sale, closed it down on the sale date—June 29, 1979—to consolidate its operations in Maryland.

Nicolas Aiello, business agent of the union at Gant, local 125 of the Amalgamated Clothing and Textile Workers, stated that Palm Beach never bought the company but was interested only in owning the Gant label to put it on imported goods. Of Consolidated Foods, he said:

> They milked it, and they dumped it. We call them absentee owners because they don't live here. They have no feeling for the people involved.

Consolidated Foods refused to disclose information on the profitability of the Gant Division, but the local branch had received an award for outstanding performance in the previous year from the parent company.

The other half of the split, the Sero Corp., functioned as an independent local company until the early 1970's when it was sold to National Apparel. According to Aiello, whose union also represents the workers at Sero, the original owner of Sero was so dissatisfied with the way the parent was operating the local branch that he waged a hard proxy fight and regained control. Since that time Sero, as a local company, has been operating profitably and has even expanded.

Ronald Kysiak, director of economic development for the city of New Haven, commented that the clothing business is very competitive and it takes knowledgeable managers to make it profitable. It seems very possible that if the Gant Corp. was having problems, it was due to a shift in ownership and management to a conglomerate. The other possible explanation for the shutdown is that the conglomerate was not satisfied with the level of profits which a local corporation might have accepted in order to preserve the operation and the jobs.

Kysiak also make comments for the purposes of this testimony which are relevant to the Bluestone and Harrison section on the hazards of absentee ownership—page 25. He stated that conglomerate operations are usually run by managers in the local area who are not authorized to make important decisions or participate in meaningful ways in the local community. This means, on the one hand, that normal corporate involvement in boards and commissions, et cetera, is absent, as are charitable contributions.

More important to him in his position as economic development administration is the likelihood that local managers are unaware of impending decisions which may affect local plants, and unable to negotiate about any problems which may be developing. He has made a practice in his work in other cities of sending representatives around the country to the headquarters of the parent companies of local subsidiaries to inquire as to the status of their operations, and offer help from the local government if it seems necessary. But he feels that such efforts are handicapped by the tendency of distant conglomerates to be unconcerned with issues of community good-will, or the well-being of local workers.

Another large absentee-owned corporation which recently announced a sudden shutdown in New Haven, and I think this is one that you are well aware of is United States Steel. This affected over 400 workers. After the shutdown, there were rumors that the physical plant might be sold to a scrap dealer which would be very low in job-intensity. The city government was unable to obtain information on possible uses of the plant from the distant corporate headquarters until it actually—in the last couple of weeks—threatened to pass restrictive zoning regulations prohibiting such a sale. Only then did a United States Steel representative agree to come to New Haven and discuss the matter which is still not resolved. This information appeared in the New Haven Register and Journal-Courier, February 1980.

Data presented by Bluestone and Harrison indicate that in 8 of the 10 New England industries studied, "The rate at which conglomerates have shut down New England business establishments relative to their rate of openings or acquisitions exceeds that of either independent or corporate owners." This appears on page 11. A quick look at the tragic history of job loss in New Haven in the past 5 years alone seems to support the casting of heavy blame on the structure of conglomerate ownership.

There have been six major situations involving significant job loss since 1975 in New Haven. Of these, only one involved solely the failure of a local company—Hull's Brewery with 400 workers. Olin and Gant's histories have been outlined. The United States Steel branch which was shut here as part of a nationwide sweep of local operations by this huge corporation, was originally begun as a local corporation in 1908—American Steel and Wire. By 1944 it employed 1,262 people. In 1973, after the acquisition by the parent, its employment level had dropped to 400. Now it is gone.

Seamless Rubber was begun locally in 1917. By 1944 it employed over 1,000 people. By 1973 it had been acquired by Dart Industries, an outside firm, and employment had dropped to 400. In 1975 the parent company announced that it was moving the operation to La Grange, Ga. The building is still abandoned.

National Folding Box was begun in New Haven in 1891. In 1944 it employed 869 people. I might add that the source of these figures is A. T. Wilder's, "New Haven's First 335 Years," published in 1974. National Folding Box was acquired by Federal Paperboard and shut down in December 1974 with a loss of 433 jobs. According to statistics compiled by the Connecticut Labor Department, New Haven's total number of manufacturing jobs dropped from 23,000 to 13,000 in the period from 1965 to 1977. It has clearly dropped further in the last 2 years as well.

Perhaps the most powerful argument available in the Connecticut context comes from a survey done by the economics research and marketing section of the Connecticut Department of Commerce. They questioned 80 companies who had moved out of Connecticut as of 1972 about the reasons for their moves. Of the 80, only 14 went out of business.

The first two reasons for the moves were consolidation of operations—28—this, of course, would usually involve a nonlocally controlled corporation with branches elsewhere—and bought by out-of-State interests and then transferred—24. Together these two reasons account for fully 65 percent of the closings studied.

I turn now to the other costs of capital mobility. One serious cost of the continuing threat of shutdowns by absentee owners is the deterioration of a healthy trade union movement. It has often been observed that large corporations tend to move plants to locations which are relatively union free, and that this is a major cause of the decline in union memberships nationwide. In a city with a tradition of active trade union activity, such as New Haven, the actual loss of members with shutdowns is only part of the deleterious effect. Dealing with large conglomerate owners in the context of regular negotiations can be very difficult. There have often been threats of shutdowns brought into negotiations in order to win concessions from local unions.

The huge conglomerates are able to sustain losses in very lengthy strikes, such as the recent 6-month strike at Olin, by absorbing them in their other operations. Large conglomerates often employ union-busting experts who roam from strike to strike organizing drives among the various subsidiaries utilizing specialized techniques to demoralize and fragment the local unions.

The major issue in the Olin strike was the right of the company to unilaterally set daily production quotas for each worker regardless of age, and fire any workers who could not meet them. This kind of demand would give the company an arbitrary means to fire any worker whose attitude they did not approve of, by setting his or her standard too high. The union fought this provision with overwhelming support from the community, but the corporation was so large it could withstand a 6-month strike without difficulty and the outcome was ambiguous.

The issue of taxes in local communities is very important both when a company shuts down because there is a great loss to the tax base, and the other thing that happens is the use of incentives in trying to get companies not to shut down.

In the Olin case, the city had offered a package which would have involved creating a 100-acre super block within the city limits. It would be very expensive. It would mean relocating many families and buying properties, and actually moving a railroad line in order to do this. It would have cost at least $6 million in tax money. In this case Olin is moving anyway, but the package was offered.

In the case of Gant, which did close, it was housed in a new building in an industrial park which was built with over $3 million of State tax money. However, many times when these incentives are offered, there is no provision made to make sure the company stays even after they are offered.

The G. & O. Co. is a subsidiary of the Allen Group, a large conglomerate. It recently did decide to stay after threatening to leave, but it only did so after the city and the State, between them, agreed to buy their old plant, but a site for the new plant, develop that site, and abate 80 percent of their taxes for 5 years. This kind of thing, the combination of the lost tax base plus the tax money that is being used for these incentives, leads to very high property taxes within these local cities which in turn then leads to both tax revolts, difficulties for individual people, and people moving out to the suburbs. It erodes the city in general terms.

The recent property tax reassessment in New Haven, which I participated in on the board of aldermen, resulted in what has been a common trend throughout New England which is that the proportion of property taxes paid by residential property owners increased from 30.9 percent to 37.5 percent. This translates into very large increases for the average homeowner. This is again, apart from even the question of the fact that tax abatements are being given to companies to keep them there which, in turn, further increases property taxes paid by individual homeowners.

The pervasive fear throughout the government of Connecticut and New Haven and many cities around the country of plants leaving and the preoccupation with setting up a good business climate to attract and keep industries again in Connecticut has led to having the highest sales tax in the Nation. It is a regressive tax. It hits poor people hard. This kind of fear persists even though that same survey by the Department of Commerce of 80 companies shows that not one single company indicated that its primary reason for relocation was either received tax concessions in a locality or high taxes in the present one. Neither of those reasons was the reason for any of those 80 moves in Connecticut.

I did want to mention that the U.S. Department of Commerce has done a study which estimates that every 100 factory workers in a town means $1,554,000 in additional personal income, $735,000 in bank deposits, one more retail establishment, 68 more persons employed in nonmanufacturing, and $847,500 more in retail sales per year. Of course, this is relevant to the health of small businesses as well.

There are statistics in here on the desperate situation of our social services, our education department, the number of people on welfare in New Haven, and these kinds of things are, of course, the result of the kinds of unemployment levels that are caused by this distant corporate decisionmaking that pulls these plants out.

I think it is important to think in this section under the broader context and for this subcommittee to be thinking about multinationals. I don't mean just in terms of the pond that you were talking about and the big fish and the small fish. The pond has turned into the world and these big fish are reducing the number of jobs in this country dramatically and are also developing an incredible amount of power over the entire world economy in ways that are not at all in the interest of this country.

One analysis of overseas relocation indicates that between 1966 and 1973 the United States experienced a net job loss of approximately 1.06 million jobs.

As I mentioned, another cost to local communities, in the most literal sense of the word, is taxes. Of course when a plant shuts down, there is an important loss in the community's tax base. But perhaps equally serious is the loss brought about by the use of incentives to persuade companies not to leave. When Winchester first hinted that it might close its New Haven operations, the city did an extensive study and offered the corporation an incredibly expensive package called the superblock proposal. It would have involved acquisition and demolition of 62 properties, relocation of 107 families, widening of some streets and closing of others to the public, and rerouting a railroad line, in order to provide a square 100-acre parcel within the city limits for Winchester construction. It would have cost, as I said, at least $6 million of tax money, and I refer here to statistics of the Yale School of Organization and Management by Don Kettl and Geoff White from 1976.

One ironic note in the Gant closing is that the plant was housed in a new facility, built on an industrial park funded with $3.2 million of State tax money. Another case in which the city spent massive amounts of money to hold a plant here involved the G. & O. Manufacturing Co., a subsidiary of the Allen group. The same Walter B. Kissinger quoted in Bluestone & Harrison as recognizing the unacceptably high "opportunity cost" of conglomerate mergers—page 14—came to New Haven to threaten to pull out their G. & O. subsidiary unless the city provided massive subsidies.

After extensive negotiations, the city and State together agreed to buy the old plant, buy and develop a site for a new one, and abate 80 percent of the taxes for 5 years, as I mentioned earlier. The total cost of saving these jobs will be between $4 and $5 million, and, as I said, there is no guarantee that the plant might not relocate at the end of that 5-year period. These types of massive tax subsidies offered out of fear of shutdowns are particularly difficult for a local community to sustain at a time when high unemployment fed by previous shutdowns has increased the need for spending on social services and welfare.

The loss of tax revenue due to subsidies increases the tax bite for the average citizen of a local community such as New Haven, as does the decline in the industrial tax base. The problem of soaring property taxes makes it more difficult to attract residents to the city. New Haven reassessed its property last year for the first time in over a decade, and the proportion of property taxes paid by residential property owners increased from 30.9 percent to 37.5 percent, while the combined commercial and industrial proportion declined from 44.9 percent to 40 percent. This shift, in addition to favorable abatements for industry, has meant a tremendous increase in property taxes in most city neighborhoods, and contributed to a wave of tax protests and moves to the suburbs.

At the same time, the average working-class taxpayer is suffering under the burden of Connecticut's 7 percent sales tax, the highest in the Nation. There is a proposal by the Governor to increase it this year, with the full knowledge that it is one of the most regressive taxes possible. This proposal is supported by most politicians on the grounds that it would be disastrous to increase any business taxes because the climate for attracting and keeping businesses might be damaged.

This kind of mentality, the pervasive fear of capital relocation, places intolerable burdens on the average citizens in order to protect the profits of distant corporations who care little for the well-being of our city or State. The mentality by the State government persists despite its own evidence, from the survey mentioned previously by the Department of Commerce, that of the 80 companies surveyed, not a single one indicated that its primary reason for relocation was either "received tax concessions" in a new locality or "high taxes" in the present one.

The combined effect of shutdowns and corporate tax subsidies has a disastrous effect on the local economy, and the lives of the people and neighborhoods. The Chamber of Commerce of the United States has estimated that each 100 factory workers in a town means: $1,554,000 in additional personal income; $735,000 in bank deposits; 1 more retail establishment; 68 more persons employed in nonmanufacturing; and $847,500 more in retail sales per year. I would mention here that these figures were taken from statistics of the U.S. Chamber of Commerce, August 1976.

In New Haven, over 60 percent of our 19,000 children in the public schools are on welfare. Our parks department maintenance staff has been cut by over 50 percent in the past 4 years. Our social services, police, fire, and housing rehabilitations budgets are being cut at a time when they are more desperately needed than ever before. Our municipal unions are asked to accept unacceptable wage packages because of the fiscal crisis of the city. And the human cost—the personal suffering described so well by many researchers into mental and physical health impacts of plant closings, with suicides, divorces, poverty and misery—are all prevalent in our neighborhoods as their physical deterioration accelerates.

I now turn to looking at this in the broader context. New Haven is not an atypical case for New England. The State Commerce Department statistics indicate that major plant closings and relocations caused losses of over 20,000 jobs in fiscal years 1970–78. Data presented by Bluestone & Harrison indicate that when smaller closings are considered as well, the total number of jobs lost for the State is 238,000, with a net job loss of 27,000—from 1969–76, page 8a. One analysis of overseas relocation of American corporations indicates that between 1966 and 1973, the United States experienced a net job loss of approximately 1.06 million jobs. These statistics were taken from Edward Kelly's Industrial Exodus, Conference on Alternate State and Local Public Policies, 1977, from page 3 of the original analysis by Robert Frank and Richard Freeman.

Local and State governments are virtually powerless in the face of remote decisions of enormous multinational conglomerates. The Federal Government must take steps to regulate their activities for the protection of local communities.

The recent study team of union and public members which toured three European countries found that Europe is much more advanced in moving toward more humane mechanisms for dealing with capital relocation. Many of the recommendations for legislative consideration below are already in effect in England, Sweden, Germany, and other Western European countries.

Our recommendations are as follows:

One, advance notification of at least 1 year before a shutdown or extensive layoff: The time of notification must be adequate to explore ways to save the jobs, through transfer to other private owners, or employee stock ownership plans, help to the existing company, or other means.

Two, disclosure of financial information: This is necessary in order to determine the feasibility of any proposed mechanism for saving the jobs.

Three, funding of alternative ownership patterns: Federal money should be available for investment and startup grants and loans to help worker cooperatives develop on a large scale out of the wreckage of local shutdowns.

Four, removal of Federal tax incentives for relocation: The favorable treatment of corporate mergers and acquisitions in the tax code, the provision for writeoff of cost of relocation as a normal business expense, the deferral of taxation of overseas earnings by multinational corporations until they are repatriated, and the deduction of taxes paid to foreign governments, are among the incentives which favor relocation. I refer again to Bluestone & Harrison, page 21, and Edward Kelly, Industrial Exodus, 1977, the Conference on Alternate State and Local Public Policies. The accelerated depreciation allowance encourages the abandonment of older facilities. Tax incentives should support more rather than less stability in location of capital.

Five, programs to ease transitions of employment for workers: Such programs should at least partially be funded by the corporations whose decisions to move cause such hardship to individual employees. They should include uninterrupted pension and health benefits, severance pay, financing of relocation searches, and retraining programs.

Six, increased regulation of giant conglomerates for the public good: Worker and public representatives should be required on the boards of directors of any company large enough to have a major impact on the public welfare through its corporate decisions. Tax laws and other Federal incentives should not be geared to encourage concentration. Antitrust enforcement and legislation should be more vigorous.

Seven, full employment: In the long run, the only humane solution to the dilemmas raised by the concentration of power in a few giant multinational conglomerates and the resulting movements of capital and economic dislocation, is a guarantee of a meaningful job with adequate income for every citizen.

These recommendations are, unfortunately, not likely to be implemented as a package in the short run. The Community-Labor Alliance and other citizen groups around the Nation are working in support of both State and Federal legislation which proposes to take the first small steps toward consideration of David Smith's "public balance sheet" in evaluating the decisions of corporations. Again, this is taken from Bluestone & Harrison, page 63.

Thank you.

Mr. **Bedell.** Thank you, Ms. Richards.

Mr. Marschall?

TESTIMONY OF DANIEL J. MARSCHALL, STAFF DIRECTOR, CITIZEN ACTION, AND IN BEHALF OF THE PROGRESSIVE ALLIANCE

Mr. **Marschall.** Thank you, Mr. Chairman. I am also testifying in behalf of the Progressive Alliance. I would like to thank you for giving me the opportunity to speak to you today about a problem that is vitally important to working people in Ohio and across the country.

My name is Dan Marschall. I am the former research coordinator for the city of Cleveland, division of economic development, and am now serving as the staff director of Citizen Action, a federation of citizen organizations in five States.

I am testifying on behalf of the Progressive Alliance. Citizen Action is composed of the Connecticut Citizen Action Group, Illinois Public Action Council, Massachusetts Fair Share, Ohio Public Interest Campaign, and Oregon Fair Share.

These grassroots organizations monitor the impact of plant closings and organize at the neighborhood level in support of plant closing legislation. They also work around a variety of issues that bring them into daily contact with the suffering caused by economic dislocation and sudden job loss.

The central office of Citizen Action is located in Cleveland, a city that has the third largest concentration of major—Fortune 1000—industrial corporate headquarters in the United States. Cleveland and northeast Ohio have suffered from corporate disinvestment since the early 1970's, as illustrated by the wholesale shutdown of steel manufacturing facilities in Youngstown.

These shutdowns are caused by a variety of factors. One of the most prevalent situations is when a local company merges into a conglomerate corporation and steadily pulls away from its hometown roots. That is precisely the situation with two companies I will talk about today, the Diamond Shamrock Corp., and the Aeroquip Corp., a subsidiary of Libbey-Owens-Ford.

Diamond-Shamrock is a particularly good case study of the disastrous impact of conglomerate mergers. The company's Cleveland connections stretch back to the early 1900's, when it was incorporated as Diamond Alkali, a producer of artificial soda ash and a variety of chemical products. In 1910, Diamond Alkali constructed its first major facility in Painesville Township just east of Cleveland. This facility eventually occupied 7 million square feet, consisted of 50 buildings, and employed 2,900 workers at its height of production.

By the 1940's, Diamond-Alkali was headquartered in Cleveland, had 95 percent of its company's assets in Painesville, and became integrally tied to the area economy. The economy was managed by executives with deep roots in the Cleveland area and seemed committed to staying—until the conglomerate merger wave of the 1960's, that is.

In 1967, Diamond-Alkali and a Texas oil and gas firm, Shamrock Oil & Gas, were threatened with hostile takeovers by multinational oil companies. To fend off these moves, the two firms merged into their own conglomerate, called the Diamond-Shamrock Corp., and quickly moved to expand their foreign operations and branch into new product areas.

So in 1967, Diamond-Shamrock was involved in oil, gas, and chemicals. A dozen years later, it had acquired 13 other domestic firms. Its business now extends into iron ore shipping, seed production, real estate, yeast and baking products, plastics, coal mining, and a chocolate and citrus company.

Diamond-Shamrock's international dealings broadened in a similar manner. By 1978, it had administrative, marketing, and production facilities in 23 foreign countries, including heavy investments in countries with repressive governments, like South Africa, Brazil, and Chile. In fact, the company selected Chile as a "target country" for new investment. This was reported in European Chemical News of October 27, 1978.

In 1978, Diamond-Shamrock spent $13.5 million to purchase a chloralkali plant and office building for government of rightwing dictator Augusto Pinochet. These properties earlier had been nationalized by Salvador Allende.

When Diamond-Shamrock executives visited the new facilities, they praised the wonderful profit opportunities under General Pinochet. An executive declared:

> This country is unique in the world, in the wide possibilities that it offers for the development of our activities. Here full trade reigns supreme and full guarantees are given to private investment. A particular economic model has been implanted by the authorities and compared with others in the rest of the world, it has produced the best results.

These investments show that this sort of ever-expanding multinational conglomerate which has grown accustomed to casting aside parts of its domestic work force, also has no qualms about pouring money into countries that have banned unions, stifled freedom of the press, and have repeatedly been condemned by the United Nations for human rights violations.

Diamond-Shamrock, according to figures used by the Chilean Government, currently has $18.5 million invested in that country, making it the sixth largest American corporate investor there.

This process—of expanding into unrelated businesses and branching out internationally—predictably pulled Diamond-Shamrock away from its roots in the Cleveland area. At first, Diamond-Alkali executives retained top management positions in the new company. But Shamrock Oil & Gas representatives systematically moved up in the corporate hierarchy until, in 1975, the former president of Shamrock Oil & Gas became chairman of the new company.

The impact was especially notable in terms of the company's Painesville facility. Employees there found that company officials had a different attitude after the merger. They apparently let the plant deteriorate and scheduled more overtime instead of hiring more workers.

The final blow came in 1976 when the company announced its intention to close the plant completely and shift some of the production to a soda plant in Houston, Tex., that it had constructed several years earlier. The announcement came on the day that the company was scheduled to begin contract negotiations with hourly employees. The shutdown idled 1,200 workers and had a devastating impact on Fairport Harbor, the city where the plant was located. Half of the school budget of Fairport Harbor was provided by Diamond-Shamrock tax revenues.

At this time I would like to point out an excellent report by Sandra Sedacca on the impact of the Diamond-Shamrock shutdown and the character of company operations in Brazil.

[This report is retained in the subcommittee files.]

Mr. **Marschall.** The company also left a more serious and literally deadly legacy to its workers and residents in the surrounding area. Last year, Cleveland Press reporter, Peter Almond, conducted an in-depth investigation of the plant's long-term impact on the area. He found out that: One, large areas of Painesville Township are a "chemical wasteland" in which Diamond-Shamrock waste products are filtering into nearby rivers; two, scores of former Diamond-Shamrock employees are dead or dying from chromate poisoning, which they contracted while working in the chrome plant; and three, Diamond-Shamrock workers are 15 times more likely to die of lung cancer than the general county population.

These findings led the Cleveland Press to conclude in an editorial that, "As the Diamond-Alkali Co. evolved from a hometown enterprise into Diamond-Shamrock, a multinational conglomerate, the company seemed to become less sensitive to the problem it was creating in Lake County."

I would like to submit a selection of the Cleveland Press articles—appendix A—for insertion in the record.

[This material is retained in subcommittee files.]

Mr. **Marschall.** The final chapter of Diamond-Shamrock's Cleveland story was written last year when the company decided to transfer its corporate headquarters from Cleveland to Dallas, Tex. The decision was not unexpected, since over 60 percent of its assets are now located in Texas. Coming in the midst of a series of headquarters closings, it was another blow to the employment opportunities for Cleveland.

A similar situation—except with a more positive ending—existed in the case of the Republic Rubber Co. in Youngstown. Republic Rubber was an independent manufacturer of rubber hose that had a long history of concern for its employees. During the 1930's, for example, when it was a struggling, family owned business, the owners of the company kept the plant operating without making a profit just to keep the workers employed.

In 1963, Republic Rubber was taken over by the Aeroquip Corp. Then 5 years later, Aeroquip was acquired by Libbey-Owens-Ford, a major multinational conglomerate that started out as a glass manufacturer and has expanded into a variety of product lines.

As in the case of Diamond-Shamrock, when Libbey-Owens-Ford took over plant operations, the workers at Republic Rubber immediately noticed the difference. According to the president of the United Rubber Workers Local, Frank Ciarniello, the company began to ship equipment from the Youngstown plant to its southern nonunion operations. Even though the rubber plant was a profitable part of a highly profitable corporation, Libbey-Owens-Ford began to cut production and lay off workers. Between 1971 and 1978, the company eliminated over 600 jobs. In 1978, the parent company announced the closure of the entire facility and shifted part of the production to its Tennessee plants.

How did Libbey-Owens-Ford justify this decision to eliminate 330 jobs by wiping out one of its most profitable operations? They provided a list of standard reasons: High energy costs; high maintenance expenses; et cetera. Union officials and employees pointed out, however, that the company repeatedly had ignored suggestions that would have increased plant efficiency. The company had failed to properly maintain its electric power facilities, they charged, and had even converted its boilers from inexpensive coal to high-priced fuel oil.

I have submitted a complete background report on the Aeroquip situation as appendix B, for inclusion in the record.

[This material is retained in subcommittee files.]

Mr. MARSCHALL. In this instance, employees and their representatives in the United Rubber Workers were determined to save their jobs. White collar workers, plant supervisors, and blue-collar employees worked to reopen the plant under an employee ownership plan. They were assisted in this effort by the Ohio Public Interest Campaign, one of Citizens Action's affiliates.

After Libbey-Owens-Ford agreed to sell the plant, employees formed the Republic Hose Manufacturing Corp. and secured a loan from a local bank. This loan was in turn guaranteed by Federal agencies. Finally, the assistance of the mayor of Youngstown, Philip Richley, enabled the new firm to obtain a $1.5 million Urban Development Action Grant.

In April 1979 the firm was back in business. By November it was employing 150 persons and turning a healthy profit.

Aeroquip is an excellent example of the willingness of a conglomerate to shut down profitable sections of its total operations. But it is also an example of how creative cooperation between employees, unions, government, citizen organizations, and the private sector can retain critical job opportunities.

That is one thing I think is really unique about the Aeroquip situation. The supervisory employees joined in the effort closely and six of the supervisory personnel purchased a total of $100,000 of stock in the new company. Both sides took various kinds of paycuts and various kinds of penalties so that the top six managers that are now managing the plant took a total pay cut of $71,000 per year, and the blue-collar workers also took hourly paycuts from $6.50 to $5 per hour. Financing for the Aeroquip situation was provided by a local bank whose loan was guaranteed by the Small Business Administration and the Economic Development Administration. The city contributed $750,000 through the UDAG which bought 33 acres of the plant area and 90 of the blue-collar employees invested $70,000 in the company stock.

These brief case studies apparently reflect a phenomenon that William F. Whyte was called the "unraveling of the conglomerate merger movement of the 1950's and the 1960's." This was in his testimony in support of H.R. 11222, the Voluntary Employee Ownership and Community Stabilization Act, March 20, 1978.

Diamond-Shamrock became a conglomerate around the same time that Aeroquip and its Republic Rubber subsidiary were being purchased by a conglomerate. The results seemed almost inevitable: Cutbacks in their northern Ohio plant operations; the inadequate maintenance of production facilities; and finally, the closing of entire plants.

The late 1970's witnessed a renewed movement of conglomerate mergers. In the 1980's we can expect to see further unraveling in the form of massive plant closings. It is crucial for Congress to provide some sort of protection on the national level.

Although we are not at this time advocating any particular piece of legislation, the experience of several European countries can provide general guidelines for humanizing the impact of Economic Dislocation. Domestic efforts concerning plant closings must contain several principles that are common in Britain, Sweden, and West Germany. They are as follows: One, companies should be required to give advance notice of contemplated layoffs, plant shutdowns, or dismissals of employees; two, workers have a right to know why corporations are considering such actions; companies should be required to bargain with unions over shutdown and cutback decisions; and three, displaced workers and the affected communities should receive some sort of adjustment assistance to cushion the impact of these decisions.

These recommendations, and others, are included in Economic Dislocation, a joint report of the United Auto Workers, United Steel Workers, and the International Association of Machinists which was published May 1, 1979.

Mr. **Bedell**. Thank you very much, Mr. Marschall.

Mr. Tauke?

Mr. **Tauke**. Mr. Chairman, I have no questions.

Mr. **Bedell**. Apparently the EDA was of help in that situation that you mentioned.

Mr. **Marschall**. Yes.

Mr. **Bedell**. Mr. Tauke, we had the EDA before us. I should tell you that in the hearing we discussed a situation in Chicago about a company called Wisconsin Steel, formerly a subsidiary of International Harvester. They sold this steel company to a very small corporation called Envirodyne, who had a net worth of $8 million. To facilitate the sale, Harvester accepted a $50 million loan secured by Wisconsin Steel's plant. Then the EDA went in and loaned them money, that is, made a 90-percent guaranty on a $90 million loan to Envirodyne. The law restricts EDA from guaranteeing more than 90 percent of the loan. The purpose of that is to assure that the private lender will assume a portion of the risk. EDA could not get any lenders to accept the loan, so International Harvester, which had $50 million loaned to Envirodyne, guaranteed the unguaranteed 10 percent. EDA accepted that and Envirodyne now appears to be going bankrupt. It lost $34 million in the first three quarters of last year. That was with an $8 to $10 million net worth.

To me this raises great questions as to whether EDA was doing the right thing here. Of course in this example we see beneficial results according to Mr. Marschall's testimony. I was about to say let's forget EDA after that, but this contradicts that and it seems a little bit better.

Mr. **Levine**. Was it a guaranty or a direct loan?

Mr. **Marschall**. In this case EDA provided a guaranty of a $1.25 million loan from a local bank.

Mr. **Bedell**. And the local bank probably participated in that loan, I assume.

Mr. **Marschall**. Yes.

Mr. **Bedell**. We are well aware that the problems you folks have pointed out do exist in certain areas. Certainly we have heard of Youngstown before as well as the situation in Ohio and New Haven. We would not be having these hearings if we were not disturbed about those. We want to thank you for your testimony.

There is a vote on the floor of the House. I think it would be best if we catch that vote and come back to get the testimony of our last witness.

The subcommittee will stand in recess at this point.

[Recess taken.]

Mr. **Bedell**. The subcommittee will come back to order.

Our next witness is Mr. James Wheat, chairman of Wheat First Securities, Richmond, Va.

Mr. Wheat, we will swear you in as our witness now.

Please stand and raise your right hand.

Do you solemnly swear that the testimony you are about to give is the truth, the whole truth, and nothing but the truth?

Mr. **Wheat**. I do.

Mr. **Bedell**. Mr. Wheat, you may proceed.

TESTIMONY OF JAMES C. WHEAT, JR., CHAIRMAN OF THE BOARD, WHEAT FIRST SECURITIES, INC., RICHMOND, VA.

Mr. **Wheat**. Mr. Chairman, I appreciate the opportunity of appearing before the subcommittee. I consider myself a small business man. I am deeply committed to the American free enterprise system and to that segment of it that we refer to as the small business segment.

I have submitted my testimony for the record, and I am prepared to respond to questions.

Mr. **Bedell**. Without objection, your entire prepared statement will be inserted in the record.

Mr. **Wheat**. If I could be indulged 1 minute, I will make some general observations. I would appreciate that opportunity.

Listening to the presentation of witnesses and questions from committee members today has brought home to me the fundamental question before all of us who are interested in the American economy and the free enterprise system and small business in particular—capital formation is our main problem.

The most important element in capital formation is the individual saver. For capital to be formed, there must be the will and the ability to save.

Having saved, then there must be the incentive to invest.

Today, unfortunately, we do not have either the will to save because of the inflationary forces that have been turned loose on us nor do we have an easy situation. It is difficult to save.

Personal savings are at the lowest level in history and also at the lowest level in comparison to other free world countries.

It is indeed a matter of crisis proportion.

Not only do we not have the will and the capacity to save today—and of course this is the lifeblood of the free enterprise system—but we have many disincentives to investment. Inflation itself is a disincentive to investment.

I personally am of the opinion that regulation is a disincentive to investment, thus, I find myself in the position of pleading with the subcommittee not to bring additional regulation whether it be in the area of conglomerate mergers or other areas of corporate activity. I plead with you not to bring additional regulation to bear. Let's bring your oversight which you are bringing and bring a posture of deregulation and support of capital formation.

This will do more for the small businessman and the small business enterprise system and it will do more for employment than anything that I can think of. You as our representatives can do this for us, we hope.

I am delighted to be here, and I am prepared to answer any questions you have.

Mr. Bedell. Thank you, Mr. Wheat. We appreciate the brevity of your summary.

Mr. Wheat. Mr. Levine pointed out to me that I was the last on the calendar. Recognizing I am not the best, I decided to be very brief. [Laughter.]

Mr. Bedell. My wife would tell you that whenever I make a speech the shortest ones are the best. [Laughter.]

[Mr. Wheat's prepared statement follows:]

PREPARED STATEMENT OF JAMES C. WHEAT, JR., CHAIRMAN OF THE BOARD, WHEAT FIRST SECURITIES, INC., RICHMOND, VA.

My name is James C. Wheat, Jr. I am Chairman of the Board of Wheat First Securities, Inc., which has its principal office at 707 East Main Street, Richmond, Virginia, and thirty-eight other offices in Virginia, West Virginia, North Carolina, South Carolina, and the District of Columbia. For more than 45 years our firm has been engaged in the securities business, and I personally have been active in the securities business for more than 38 years. Our firm is a member of the New York Stock Exchange and other securities and commodities exchanges.

We render advice to various businesses in our region of the country on financial matters and to individuals, trusts, financial institutions, educational organizations and others with respect to investments. Our major emphasis is on the investment activities of individual investors and savers, who we believe provide the backbone for capital formation in this country. Less than 1.5 percent of our aggregate revenues in the past five years has been derived from effectuating mergers or acquisitions of businesses.

I appear before this committee today to discuss the effects that mergers, particularly conglomerate mergers, have on small businesses in the local communities with which I am familiar. Because I understand that the committee does not have any particular legislative proposal before it, I will keep my remarks general. However, because various proposals to curtail mergers have been suggested to this and other

Congressional committees, I will try to explain why I have deep concern over the adverse effects that such restrictions could have on small businesses in particular.

A. Small business often need to merge with large companies

In the region that we serve there are a significant number of small businesses that hope to grow and prosper. As this committee is well aware, when these businesses are successful they are a source of jobs, economic development and tax revenue for the region as well as the nation. Many of these firms were started by enterprising businessmen, or by those who had new inventions or new ideas which they wanted to develop. The stocks of the businesses are usually closely held by the founders and their families and by employees. As the businesses succeed, their stocks become valuable, but three problems in particular frequently develop as the years pass and especially when the top management near retirement age or die.

1. Mergers can provide management skills.—One of these problems that sometimes develops is the lack of able managers to succeed those who are nearing retirement or who die. This will frequently lead to efforts to sell the business or merge it with another company. The logical purchaser or acquirer of the business is a corporation, and generally that corporation will be much larger in size if it is to provide the necessary management capability and the funds or marketable securities to finance the acquisition.

2. Mergers can provide investment liquidity.—The second and even more frequent problem is that as the original owners and managers reach their later years they become increasingly concerned that, while their stock holdings in the business have become valuable, they personally have relatively little liquidity; they have comparatively little cash or readily marketable assets with which to meet federal and state death taxes and provide for their surviving spouses or relatives. In years gone by this contingency could be met by "going public," i.e., by selling some of the stock in a public offering, after which the stock would be listed on a stock exchange or traded in the over-the-counter market. But in the past decade that possibility has practically disappeared. There are very few smaller companies which in recent years have been able to market their stocks publicly. Stocks of many large companies sell in today's market at relatively low price to earnings ratios and at prices well below their net book values. In such a market it is nearly impossible to sell in a public offering the stock of a smaller company.

In these circumstances the natural purchasers with whom to negotiate a sale of the stock of the company are larger companies which have the financial capacity to make the purchase in cash at a fair price, or companies with listed stocks that can issue their shares in a merger and provide liquidity for the owners. Any restrictive merger legislation that would eliminate as potential buyers those that are best able to pay a fair price would require the owners to look elsewhere for purchasers or even force them to liquidate, with a resultant unfortunate loss of employment. The limitation on the field of purchasers would dearly cost the owners of these successful businesses that ultimately find themselves in their later years with a need to sell.

3. Mergers can provide needed capital and other resources.—A third problem that often occurs for a successful and developing business is an urgent need for additional capital to finance expansion, additional plant and equipment, inventories, research and development, new products, advertising and a variety of other reasons. There are limits to which the smaller company can borrow additional funds for these purposes. Until the past decade or so the companies, as I have previously noted, could frequently turn to the public markets and sell preferred or common shares to raise needed capital. But the state of the stock market in recent years has been such that for all practical purposes this avenue has been closed or is prohibitively expensive to the smaller growing company.

Large mature companies, though subject to some of the same difficulties in the equity markets, nonetheless have a greater ability to provide capital needed for expansion of thriving smaller companies. A merger or acquisition is a natural result of these current economic and financial factors that cause these companies to gravitate toward each other. A legislative attempt to block this natural gravitation without available alternative opportunities for debt or equity financing for growing companies seems to me self-defeating. It would decrease capital formation at the very time that we are striving to stimulate capital formation as a national goal.

4. Mergers provide an incentive for the creation of new businesses.—There are, of course, many other reasons why smaller growing businesses may be sold or merged. Some of these reasons may develop suddenly and unexpectedly; in other instances the transactions may simply carry out the long-range objective of the enterprising businessmen and investors. Denying the possibility of selling or merging with a larger company that is best able to pay a fair price would, I think, be an obvious discouragement to persons who take the necessary risks and devote the years of effort to establish and develop a new business into a major success. This would be particularly true for a company whose development and success has been based on a single product or service. Indeed, I am an investor and a director of a corporation employing some 150 to 200 people—in an economically "depressed" area of Virginia—which I believe would not have been started if legislation restricting its ultimate ability to be sold to a large company had been in effect.

The impediment that restrictive merger legislation would impose on a smaller successful business I believe would have a chilling effect on the willingness of businessmen to assume these risks and dedicate their careers to establish and build up new business enterprises. If they were fortunate enough to achieve success and their sales neared the threshold of the legislative restrictions, they would have to consider carefully whether their company might be found by the courts to come within the prohibitions of the legislation. If the company might be so regarded, they would have to weigh selling or merging with a large company before they crossed the dividing line or thereafter be barred from doing so. Indeed, it is these companies below the dividing line that the larger companies would be interested in acquiring, since the acquisition would be forbidden once the line was crossed. Facing this unfortunate choice would not be a happy prospect for many of these energetic successful people in the prime of their life. If they have heretofore passed the dividing line, they would be deprived of the best available market for their companies, to which they had looked forward when and if they reached the point in time when a sale might be necessary.

Obviously a sale or merger should not be permitted if it would result in a restraint of trade or tend to create a monopoly, because of the adverse effect on consumers, and I understand that current law prohibits any such transaction. But to bar a sale to a substantial number of large companies seems to me an arbitrary and unwarranted penalty upon the owners of smaller businesses—especially if imposed without proof of any corresponding public benefit.

B. Mergers involving larger companies can have substantial beneficial effects on local communities

As I considered my testimony today, I reviewed a recent financial statement of one of our successful businesses in Richmond that not very long ago was a small business but now has sales in excess of $350 million. This business was founded approximately a hundred years ago in Richmond, and through the years has prospered under the dynamic leadership of the grandson of the founder of the business. Its stock was eventually listed on the New York Stock Exchange, and some ten years ago the son made a gift of stock in the company to the University of Richmond, his alma mater, worth $50 million—at the time the largest single gift to an educational insitution in the United States. Over a period of time the company has acquired several related businesses, including businesses headquartered in Richmond, and these businesses have made major contributions to its success.

I see no reason not to expect that further acquisitions would have similar beneficial effects on the company and the Richmond community. Moreover, although there is no reason for it to do so now, I see no reason for it it be barred from merging with another company of its size or larger no matter what conditions might eventuate in the future. Absent an affirmative showing that such a merger would be harmful, I would presume that an arbitrary merger ban on the company would be to its detriment and to that of its shareholders, including the University of Richmond.

Let me illustrate with another case important in my home town of Richmond. The Life Insurance Company of Virginia and Lawyers Title Assurance Company were founded many years ago and grew as two of our major companies in Richmond. Eventually the two companies were merged through the formation of a holding company, with its stock listed on the New York Stock Exchange. In 1977 the stock had fallen in value, along with many other stocks, and was selling at about $11 a share, far below its book value. Much of its stock was held locally, and many shareholders were concerned about its low price. Continental Group, Inc. then approached the management with an offer of a merger that, as finally worked out, would give the Richmond shareholders stock of Continental worth about $28, or cash in that amount, for each share of Richmond stock. The directors of Richmond were divided as to whether the offer should be accepted, but finally by a substantial majority recommended it to the shareholders, who approved it by a vote of more than 96 percent.

I can conceive of no reason of public policy why the Richmond shareholders should have been denied the right to receive $28, which I advised my clients was a fair value for the stock, and relegated to the $11 price which an undervalued stock market put on the stock. I know of no harm whatsoever that has occurred to the public from the transaction, and absent a showing of some such harm I can conceive of no adequate reason for banning it.

Our region is a center of the tobacco industry, which is increasingly involved in controversy relating to the medical effects of smoking. Some of the major companies in the industry have sought to diversify their business interests through acquisition of companies in other fields. Recently, for example, Liggett & Myers acquired Atlantic Pepsi-Cola in our region in a transaction that I believe would have been prohibited if some of the merger restrictions that have been proposed had been in effect. The transaction was desirable for both companies, and their shareholders, and I see no harm whatsoever that it can cause to the public. Other tobacco companies of substantial size headquartered in our region are also seeking to diversify through acquisitions, and as long as there is no restraint of trade or threat of monopoly involved I find no reason to require them to remain in a threatened industry or start out afresh in new businesses in which they have no experience.

C. Restrictive conglomerate merger legislation based on size would have a variety of perverse effects

Proposals for restrictive conglomerate merger legislation generally rely upon the size of a company's gross assets or sales as the test of a perceived, but not articulated evil. Size tests lead to a number of problems, among them the following:

1. Different industries have leading companies of widely different sizes. A company with, say, $350 million in assets or sales may be dominant in one industry but a small business in another. A bank, a savings and loan association, or an insurance company with $350 million in gross assets would be overshadowed by many companies of far larger size. For example, there are eight banking organizations in Virginia alone with assets of more than $350 million.
2. Many businesses are subject to federal or state regulation and must obtain approval of a public regulatory board to participate in a merger or acquisition. These companies include banks, savings and loan associations, life and casualty insurance companies, railroads, airlines, public utilities, and television stations. Any bill that imposes a size test atop the numerous standards that the regulatory bodies already apply in determining whether the transaction is in the public interest would seem unnecessary, at the minimum. Yet, if regulated industries were exempted from such a bill, other problems would exist, including the treatment of companies owning both regulated and unregulated businesses.
3. The meaning of the term "assets" as used in determining the size of companies is difficult to understand. Presumably it refers to gross assets as reflected in published financial statements. Such a test would have arbitrary effects, since companies might acquire additional gross assets with borrowed funds or reduce gross assets by selling them and reducing outstanding debt or securities. An entirely new set of possible manipulations and interpretive rules would develop as companies would seek to fall below the cut-off line of any restrictive merger legislation to permit mergers or sales or to climb above the line to prevent them. Other types of transactions would develop, such as the sale of less than a majority of the assets of a company to one purchaser and a simultaneous similar sale to another purchaser.
4. The reliance upon size as the applicable test would ignore the needs of the particular business. Changes in the circumstances of an industry can produce serious requirements for additional capital that can only be obtained through merger or similar transactions. New energy or environmental costs, or a sudden increase in competition from abroad, can place a smaller business in an untenable position. Restrictive merger legislation could leave such a business without a viable opportunity to maintain profitable operation.

In our work as advisers to investors we are constantly concerned with the prospects of the stocks of public companies. As I contemplate the effect that restrictive merger legislation would have, I have special concern over the effect that it might have on the market prices of stocks, already selling at depressed levels in relation to dividends, earnings, and book values. It seems to me that such legislation would necessarily have an adverse effect on those prices, to the detriment of shareholders, and produce another downward force on the market generally. In today's inflationary worldwide economy I think investors would view with great concern these limitations on management's opportunities to employ capital efficiently, to diversify risks, and to shift into other business fields when old ones are maturing or beset with new problems.

For the past decade investors have left the stock market in large numbers. We need to encourage their interest in common stocks, not to inject new discouragements. The restraints that restrictive merger legislation would impose on large companies as well as smaller ones that might wish to merge with or sell to them would, I think, have a serious depressing effect on market prices generally. It would inhibit capital formation and raise the cost of equity capital—if it can be found, and this would be especially so for the smaller companies.

In considering the possibility of restrictive conglomerate merger legislation, I have speculated over the precedent it might establish. If one believed that farm lands were too highly concentrated in large tracts, should we consider prohibiting anyone owning more than 350 acres from acquiring another tract of more than 350 acres? If one believed that unions may at times be too powerful, should we prohibit a union with more than 10,000 members from merging or affiliating with another union having more than 10,000 members? Should we adopt similar rules with respect to ownership of timber lands or to the size of cooperatives? We have had for many years antitrust laws that have served us well in prohibiting monopolies and restraints of trade, but arbitrary limits based on size alone seem to me inherently unwise and inimical to an ever growing and developing economy.

I urge this committee to refrain from developing legislation that would place the businesses of the country in an arbitrary economic straitjacket. Years ago there was a proposal for a federal law to put a ceiling of $25,000 on the salary that might be paid to any individual; imagine the difficulties such a law would have produced! I also recall a proposal when the Investment Company Act was under consideration in the late 1930's to limit the size of investment companies to $100 million; yet today we have mutual funds with assets of more than $2 billion, and they have rendered important services to the investing public and to the entire capital formation process. Again, there were for some years efforts to combat chain stores; but chains of supermarkets and discount stores have provided great benefits to consumers. Arbitrary straitjackets fail to take into account the manifold needs of a developing economy.

My own experience as a regional investment banker leads me to emphasize again my special concern over restrictive merger legislation that would deny to owners of smaller businesses access to the most likely purchasers if and when the time comes that a sale or merger is advisable. In this regard I would stress that such legislation would run counter to an economic law of gravity. Those that have stock in a business to sell, and who do not today have a reasonable opportunity to make a public offering at a fair price, naturally seek a buyer who will offer it. Larger companies that can provide management and can offer the necessary cash or marketable securities are logical bidders. Restrictive merger legislation that would remove those companies from the list of potential buyers would do so to the great detriment and discouragement of those who start and develop new stimulating enterprises. I would not object if I could perceive a significant demonstrated advantage to the American public, or a substantial demonstrated evil that could not otherwise be circumscribed. But there is none, and accordingly I respectfully urge this committee to refrain from developing new restrictive conglomerate merger legislation.

Mr. Bedell. Mr. Tauke?

Mr. Tauke. Mr. Chairman, you will recall that it was President Truman who said "If you want me to give an hour speech, I will start now, and if you want a 10-minute speech, then give me a week to prepare it."

Your testimony seems to be very comprehensive. I have not had time to review it completely, but let me say a word or two about your comments relating to savings and investments.

I strongly concur with you that we have very serious problems in our economy because we, as people across the country, have not been saving. I agree also that we need to provide strong incentives to encourage those savings to be invested.

What I am not clear about is how you believe that the issue of savings relates to the question that we have before us concerning to mergers and conglomerate mergers and the survival of small business. Could you elaborate?

Mr. Wheat. Certainly.

As I indicated in my general comments, we can save, but if we do not have incentives to invest savings, they do not produce the economic returns and the social returns that we all want.

Today we have the disincentives in terms of inflation and in terms of regulation and in terms of many external factors also. We have the Arab situation and other factors.

In my judgment, a bill which was proposed on the Senate side, Senate bill 600, was supposed to control conglomerate mergers or, in effect, all mergers is another disincentive to investment.

The free marketplace is the best regulator as long as there is that oversight function served by this Congress and so that the free marketplace in those situations will indeed be the most effective economic generator for the benefit of the most people.

I have read, and I have heard today where conglomerate mergers have had an adverse effect on certain communities. Our experience in the territory in which I live in Richmond, Va., and also in West Virginia and North Carolina is exactly the opposite. Mergers of Tenneco acquiring Newport News Shipbuilding has not been to the disservice of the community or its employees. Indeed, I question whether that shipyard could today function as it did for many years as a single unit entity.

The Ethyl Corp., one of our fine corporate citizens, is under the hammer blows of the rules of OSHA and the EPA. So they have to diversify. They have got to acquire because they have been put under the gun, so to speak.

Another of the finest corporate citizens in America, in the fullest sense of the word, is Philip Morris. Because of governmental action it is of necessity diversifying with the conglomerate merger approach. Therefore, conglomerate merger is not an all-evil situation. Far from it. In our case it is a highly positive and effective free market force and it has produced good for the overall community in terms of social, economic, cultural, and educational factors—just straight across the board.

The introduction of an additional impediment, if you will, in the free market process in terms of the transfer of property is just another disincentive to investment.

Mr. TAUKE. Although I am still in the process of learning about this whole subject area and am attempting to formulate judgments, I think that at this point it has been relatively clear to me that some of the mergers that have taken place have been very beneficial. Some have not been.

At this point I am not anxious to restrict the normal market processes. I certainly do not believe that we should automatically prohibit all mergers of a certain size.

However, it does appear to me that there are some mergers that are occurring that are not the result of normal market forces and are, therefore, not appropriate.

It seems to me that some of those are occurring because of certain governmental policies, some of which we have discussed in this hearing this morning.

Would you concur with me that there are some mergers which are occurring that are not the result of normal marketing processes and also that they are caused in part by governmental policies which seemingly might be unrelated to this, such as various tax laws and so on?

Mr. WHEAT. I do not know whether I could agree with you not knowing your definition of normal market forces.

If I may, let me give you a personal experience of a company at one end of the spectrum in which I happen to be an investor. I am an unhappy investor at this point.

This company would never have been formed if there had not been the prospect for it to merge. I refer to this in my written testimony. That company is in deep trouble, but one of these days we hope that it is going to be an effective unit. But it is a technology-type situation that needs to be developed and matured. At some point in time it can be better developed and enhanced by some unknown and perhaps today nonexistent acquirer.

There can be abuses of any process, of course. You are here for the purposes of oversight.

I do not know readily what I would call abuses of the normal marketplace. None come to mind readily as to the abuse of that normal marketing function that you refer to. That does not mean it does not exist, but I don't know of it.

Mr. TAUKE. Thank you for your testimony.

Thank you, Mr. Chairman.

Mr. BEDELL. We particularly appreciate your testimony, Mr. Wheat, because it was the desire of this subcommittee to try to get views from all angles. Your view is somewhat different from what we have had from some other people who have testified. We particularly thank you for being here.

Are you in the consulting business?

Mr. WHEAT. I am chairman of the board of Wheat First Securities. We are members of the New York Stock Exchange. We are in the investment banker and brokerage business. We compete with those small fellows like Merrill Lynch and a few others. We operate in a region of Virginia and North and South Carolina.

Mr. BEDELL. Are you involved in working with businesses that are interested in merging?

Mr. WHEAT. Yes, sir. That is a small part of our overall business.

Mr. BEDELL. In that regard, you get to see how the tax laws operate. Do you have an opinion as to any possible changes that would be advisable with regard to our tax laws as far as merger activity is concerned? We are interested in trying to make it possible for the small business person to be able to continue to compete in our society if possible.

As a sideline of these hearings we have been concerned about some of the social impacts that at times appear to have occurred as a result of mergers and takeovers.

Mr. WHEAT. I personally think that the tax rates are unhappily too high on business and on individuals. I am sure that you gentlemen would love nothing better than to find some way to reduce those taxes.

Obviously, we have the other side. We have got to meet the costs of government. The costs of government, in my opinion, are vastly too high. This is where the tax cut comes. We have got to attack the costs of government, not just at the Federal level but across the board. We need to reduce taxes but must have the room to reduce them. A reduction in taxes, for example, without a corresponding reduction in expenses can only, in the short run, increases inflationary pressures, and inflation the No. 1 enemy, of course.

Therefore, I personally feel that anything you can do to increase incentives in terms of additional production and additional productivity would be highly beneficial.

I was unaware that you had a bill before Congress to increase the rate point from $100,000 to something higher for the maximum corporate tax rate.

I think this is certainly a move in the right direction. However, I think the entire area of taxes needs to be addressed. The starting point for significant tax reduction is first a limit on expenditures and then a reduction of expenditures.

Mr. **Bedell**. If it were the feeling of the Congress that it would be more beneficial to our society to make it more possible and, in fact, more attractive for an entrepreneur who wanted to sell his business to sell it to another entrepreneur or to a smaller corporation as compared to a bigger one, then would you have any suggestions as to changes in Government laws that might make that arrangeable? Would you have an opinion as to what could be done in this area?

Mr. **Wheat**. I think you would probably be creating another nightmare with such an action. This is just one man's opinion.

I think the transfer of property and the capital gains tax which existed up until 15 months ago or so when it was changed was one thing. There was a capital gains lifted just prior to that. I think it was 1976. I am rusty on my dates. That capital gains tax was up to 40 some percent on an individual. That was confiscatory. It was clearly a disincentive to investment.

The Congress, I think, made a great move toward correcting that in the bill that they passed last year.

Any time we talk about the transfer of ownership and giving special privileges to some defined group, then I think we had better be very careful in terms of how we do this or otherwise we are going to create inequities. As ingenious as these 225 million Americans are, I think they will find ways and means to accommodate to this in a way that you do not want them to. They will not meet your objectives, I don't think.

I repeat again—I know of no case where the conglomerate merger, per se, is the cause and effect of economic or social problems.

That is not to say it does not exist. I am simply saying that the merger itself I don't believe is the cause of it. On the contrary, I can cite examples where the result has been beneficial in the fullest sense of the word to the cultural, educational, economic, and social well-being of companies and communities.

Mr. **Bedell**. Are there any further questions, Mr. Tauke?

Mr. **Tauke**. No, sir, Mr. Chairman.

Mr. **Bedell**. If not, we appreciate very much your testimony, Mr. Wheat, and we thank you for coming to be with us.

The subcommittee is adjourned.

[Whereupon at 11:40 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

blank page

APPENDICES

Appendix A.—Companies Discussed in the Hearings

COMPANY AND LOCATION

January 31

American Optical Co./Warner Lambert, Southbridge, Mass.
American Woolen Co./ Textron, Southbridge, Mass.
Arrow-Hart, Lewiston, Maine.
Bates Fabrics, Lewiston, Maine.
Bates Manufacturing, Delaware.
Boston Gear, Boston, Mass.
Collins Radio/Rockwell International, Cedar Rapids, Iowa.
Colonial Cooperative Press/Sheller Globe, Clinton, Mass.
Condata Systems, Minneapolis, Minn.
Draper Looms/Rockwell International, Hopedale, Mass.
First National Food Stores, Boston, Mass.
Hopedale Realty Trust, Hopedale, Mass.
Pick-n-Pay, Cleveland, Ohio.
Pratt & Whitney/United Technologies, E. Hartford, Conn.
Victoreen/Leece Neville Corp., New York, N.Y.
Virginia Iron, Coal & Coke, Delaware.
Windsor Industries, Delaware.

February 1

American Safety Razor Co./Philip Morris, Staunton, Va.
BIC Corp., France.
Jones & Laughlin, Youngstown, Ohio.
LTV, Youngstown, Ohio.
Lykes Corp., Youngstown, Ohio.
United States Steel Corp., Youngstown, Ohio.
Wheeling-Pittsburgh, Pittsburgh. Pa.
Youngstown Sheet & Tube, Youngstown, Ohio.

February 7

American Safety Razor Co./Philip Morris, Staunton, Va.
Federal Glass, Montvale, N.J.
ITT-Continental Bakers, Syracuse, N.Y.
LTV, Youngstown, Ohio.

February 8

Anderson Metals, Syracuse, N.Y.
Barlow Johnson, Syracuse, N.Y.
Basler Electric Co., Syracuse, N.Y.
Bernard's Contemporary, Syracuse, N.Y.
Carrier Corporation/United Technologies, Syracuse, N.Y.
Central Fence Co., Syracuse, N.Y.
Chamberlin Rubber Co., Syracuse, N.Y.
Cooper Decoration, Syracuse, N.Y.
Draper Looms/Rockwell International, Hopedale, Mass.
Eastern Ambulance Service, Syracuse, N.Y.
Edro Business Forms, Syracuse, N.Y.
Erie Industrial Sales, Erie, Pa.
Estabrook Printing, Syracuse, N.Y.
Furcinito Construction Co., Liverpool, N.Y.
Goodyear Tire & Rubber Co., Akron, Ohio.
Higbee Rubber Co., Syracuse, N.Y.
Highgrade Metal Products, Syracuse, N.Y.
Howard's Shoe Store, Torrington, Conn.
Hurbson Office Equipment Co., Syracuse, N.Y.

Industrial Fabricating Corp., Syracuse, N.Y.
Jardine Bronze & Aluminum Foundry, Baldwinsville, N.Y.
JGA Construction Co., Syracuse, N.Y.
MacAlaster Bickwell, Syracuse, N.Y.
Mahoning Culver, Canfield, Ohio.
Mid-State Elevator Co., Syracuse, N.Y.
Moreland & Sons Signs, Syracuse, N.Y.
Nash Machine Co., Syracuse, N.Y.
National Can, Baltimore, Md.
Nicholson File Co./Cooper Industries, Providence, R.I.
Onondaga Supply Co., Syracuse, N.Y.
Poster Cable Power Tool Manufacturers/Rockwell International, Syracuse, N.Y.
Quinlivan, Pievik & Krause, Syracuse, N.Y.
Rath Meatpacking, Waterloo, Iowa.
Screen Graphic Arts, Syracuse, N.Y.
Sealing Devices Inc., Lancaster, N.Y.
Selflex Siren Products Co., Syracuse, N.Y.
Smith & Caffrey Steel Corp., Liverpool, N.Y.
Spaulding and Associates, Syracuse, N.Y.
Syracuse Fasteners, Syracuse, N.Y.
Syracuse Industrial Sales Co. Ltd., Syracuse, N.Y.
Torrington Co./Ingersoll-Rand, Torrington, Conn.
Uniroyal Rubber Co., Chicopee, Mass.
United States Steel, Youngstown, Ohio.
West End Brewing Co., Utica, N.Y.
Woodcock & Associates, Inc., Syracuse, N.Y.
Woodward Corporation/Mead Corporation, Bessemer, Ala.
Youngstown Sheet & Tube, Youngstown, Ohio.

February 12

Armour & Co./Greyhound, Mason City, Iowa.
Bates Fabrics, Lewiston, Maine.
Chicopee Manufacturing, Chicopee, Mass.
Federal Mogul Corp., Detroit, Mich.
Ford Motor Co., Dearborn, Mich.
General Motors Corp., Detroit, Mich.
Genesco, Nashville, Tenn.
K-Mart, Troy, Mich.
Mack Truck, Allentown, Pa.
Montgomery Ward/Mobil Oil, New York, N.Y.
McGraw Hill/American Express, New York, N.Y.
New England Provision Co., Dorchester, Mass.
Peabody Tannery, Peabody, Mass.
Sheller Globe/Colonial Press, Clinton, Mass.
Sperry Rand, Herkimer, N.Y.
Textron, Providence, R.I.
United Technologies/Carrier Corp., Syracuse, N.Y.
United States Steel Corp., Youngstown, Ohio.
Universal Atlas Cement Co./United States Steel, Hudson, N.Y.
Wilson Foods/ LTV, Dallas, Tex.
Youngstown Sheet & Tube, Youngstown, Ohio.

February 27

International Harvester/Wisconsin Steel Corp., Chicago, Ill.
Jones & Laughlin, Youngstown, Ohio.
United States Steel Corp., Youngstown, Ohio.
Youngstown Sheet & Tube, Youngstown, Ohio.

February 28

Aeroquip Corp./Libby-Owens-Ford, Cleveland, Ohio.
Diamond Shamrock Corp., Cleveland, Ohio.
Ethyl Corp., Richmond, Va.
G. & O. Co./Allen Group, New Haven, Conn.
Gant Corp./Consolidated Foods, New Haven, Conn.
National Folding Box/Federal Paperboard, New Haven, Conn.
Philip Morris, Richmond, Va.
Seamless Rubber/Dart Industries, New Haven, Conn.
Sero Corp., New Haven, Conn.
Tenneco-Newport News Shipping, Richmond, Va.
United States Steel Corp., Youngstown, Ohio.
Winchester Corp./Olin, New Haven, Conn.

APPENDIX B.—ABATEMENT AGREEMENT BETWEEN ROCKWELL INTERNATIONAL CORP. AND THE TOWN OF HOPEDALE, MASS.

AGREEMENT made this 30th day of April, 1978, by and between Rockwell International Corporation (Rockwell) of Pittsburgh, Pennsylvania, and the Board of Assessors of the Town of Hopedale, Massachusetts, a municipal corporation of the Commonwealth of Massachusetts (the Town).

WHEREAS, Rockwell filed applications dated October 28, 1977, for abatement of real estate taxes pursuant to G. L. Ch. 59, §59 on certain property assessed to it within the Town commonly known as the "Main Plant", "Office Building", and the "West Foundry" and

WHEREAS, the Assessors denied by inaction said applications for abatement and

WHEREAS, Rockwell appealed to the Commonwealth of Massachusetts Appellate Tax Board on March 16, 1978, for a determination of the amount of abatement, if any, to which it was entitled and

WHEREAS, the Assessors and Rockwell have agreed to settle the pending applications for abatement and also to establish new valuations for the property of Rockwell within the Town for the years 1979-1982.

NOW THEREFORE:

1. The Assessors agree with Rockwell as follows:

a) To grant a reduction of assessed valuation in the amount of $4,000,000.00 of property owned by Rockwell within the Town for fiscal year 1978, which reduction shall result in an abatement of real estate taxes paid for fiscal 1978 in the amount of $218,000.00.

b) To reassess or revalue the property of Rockwell within the Town as of January 1, 1978, establishing thereby effective valuations to be used in connection with the 1979 fiscal year tax bills. The new assessments shall be divided into five major categorize as a matter of convenience as follows:

* 1/1/77 Ass'd Value						* Tax Defecit FY '78 caused by abatement
1.$9,886,490	=$538,813.70	1.	Main Plant	-	$6,450,000.00	$209,000.00
$2,104,540	=$114,697.43	2.	West Foundry	-	750,000.00	(Abatement was $218,000.00
$ 906,280	=$ 49,392.26	3.	Office Building	-	450,000.00	Overlay was $10,000)
} 839,690	=$45 , 763.10	4.	Improved Land	-	450,000.00	
		5.	Vacant Land	-	1,600,000.00	
$13,737,000.			Total:		$9,700,000.00	

c) To reassess or revalue the property of Rockwell within the Town as of January 1, 1979, establishing thereby effective valuations to be used in connection with 1980 fiscal year tax bills as follows:

1.	Main Plant	-	$5,750,000.00
2.	West Foundry	-	750,000.00
3.	Office Building	-	450,000.00
4.	Improved Land	-	450,000.00
5.	Vacant Land	-	1,600,000.00
	Total:		$9,000,000.00

---

*These figures do not appear in signed Agreements. Added here for comparison & explanation purposes.

d) To reassess or revalue the property of Rockwell within the Town as of January 1, 1980, establishing thereby effective valuations to be used in connection with 1981 fiscal year tax bills as follows:

	1.	Main Plant	-	$5,050,000.00	
	2.	West Foundry	-	750,000.00	
	3.	Office Building	-	450,000.00	
	4.	Improved Land	-	450,000.00	
*	5.	Vacant Land	-	1,600,000.00	*
$13,737,000 minus		Total:		$8,300,000.00	= $5,437,000.00 loss in tax valuation & $345,249.00 revenue

2. In the event that the laws of the Commonwealth of Massachusetts are changed relative to the method of assessment, date of establishment of assessed value, fiscal year, or in any other manner, nevertheless, it is understood and agreed that the intended purpose of the above mentioned revaluations shall be carried out to the fullest extent possible.

3. In the event that Rockwell sells or otherwise disposes of any parcel or parcels of land within the Town, it is understood and agreed that the assessed value of the said parcel or parcels sold or disposed of shall be removed from the valuation category in which it falls and the total assessment as described above for the property of Rockwell, shall be reduced accordingly; said removal to take place at the date provided by law which is at present January 1.

* Not in original agreement
Added for Explanation

In order to facilitate the above, the Town agrees to provide separate tax bills for each existing individual parcel owned by Rockwell, commencing with the bills issued for fiscal 1979.

4. The Assessors shall furnish reasonably satisfactory evidence to Rockwell from time to time, at its request, that the revaluations described above have been carried out. In the event that the tax bills at any time fail to reflect the changed valuation described above, Rockwell reserves all its legal rights relative to application for abatement of any or all the tax imposed on it by the Town.

5. Rockwell agrees with the Town that it shall file Withdrawals of the appeals now pending before the Appellate Tax Board for fiscal 1978 upon the execution hereof or upon receipt of other satisfactory evidence of granting of abatements for said year as described above.

The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

Executed as a sealed instrument on the day and year first above written.

Board of Assessors of the Town of Hopedale

By: ______________________
Chairman

____
Member

____
Member

Rockwell International Corporation

By: ______________________

The abatement to Rockwell International on it's property owned in Hopedale on January 1, 1977 took place in April of 1978.

The abatement of approximately $218,000.00 was applied to the May payment (1978) of the amount due from Rockwell. This means that the Fiscal 1978 ta x levy was short $209,000.00. The difference between the $218,000.00 and the $209,000.00 is the fact that we had provided for approximately $10,000.00 more in the overlay (abatement & exemption) account than was normally provided for. This overlay account is the manner in which all towns and cities provide for the fact that by statute it will not collect the full amount due on the tax bills (e.g elderly, vets, widow exemptions). When the overlay is off the mark, it is either a deficit or a surplus. The former is when the provision does not meet the actual exemption or abatement amount grant (i.e. the situation that happened in fiscal 1978) The latter is when the provision exceeds the actual amounts.

The ideal situation is to have the two accounts equal or greatly approximate one another. Any great variance means that the tax bills have either raised too much or too little and this is to be avoided. We raised too little in 1978 because of the Rockwell abatement. However, since no one could predict
1. Whether an abatement would be sought.
2. The amount to be sought and since the only way to provide for the amount would have been to raise taxes substantially before the fact, then indeed it becomes apparent that the provision made for fiscal 1978 was an appropriate action.

The tax recap sheet is nothing more than an attempt to balance the town's cash outlay with it's income. All expenditures must be accounted for, all revenues must be collected to pay for our obligations. Obviously, the abatement to Rockwell made this impossible. Further, the only way we were able to meet our obligations was to rob Peter. That is, we drew from cash assets the State had not certified for our use and which we had not provided for to be used to pay our bills.

By state law, the overlay deficit must be wiped out on the recap sheet the following year (1979 in this case). This would be money we would collect to replenish our cash position which we depleted to tide us over the fiscal 1978 year. It is in one sense a bookkeeping concept, in another a very real cash need.

The bookkeeping part of it is that it must be raised at a certain point in time whether or not we really need the money at that point in time. Granted that the money must be replenished sooner or later, the town sought not to have to do it through the fiscal 1979 tax levy. The reason is obvious. On this particular abatement, the fiscal 1979 recap sheet would have reflected a $208,000.00 overlay deficit, yeilding a tax increase of $7.00 per thousand. But, also the tax recap sheet sould have reflected a diminished valuation necessitating another $7.50 increase.

Because of this one time, first year double penalty, the town was facing a $15.00 tax increase rather than the eventual $8.00 tax increase (27% rather than 15%). Therefore, other alternatives were sought. The town was going to approach the Department of Revenue, and petition them to allow us not to raise the overlay deficit this year and rather fund it through bonding over five years; this would allow the town to "write-off" the deficit at regular intervals. It would allow for an orderly treatment of this one time double penalty, and would allow the town to take into consideration this abatement and it's ramifications at it's budget hearings and it's Annual Town Meeting. Neither of the last two parts were possible because of the timing and nature of this abatement.

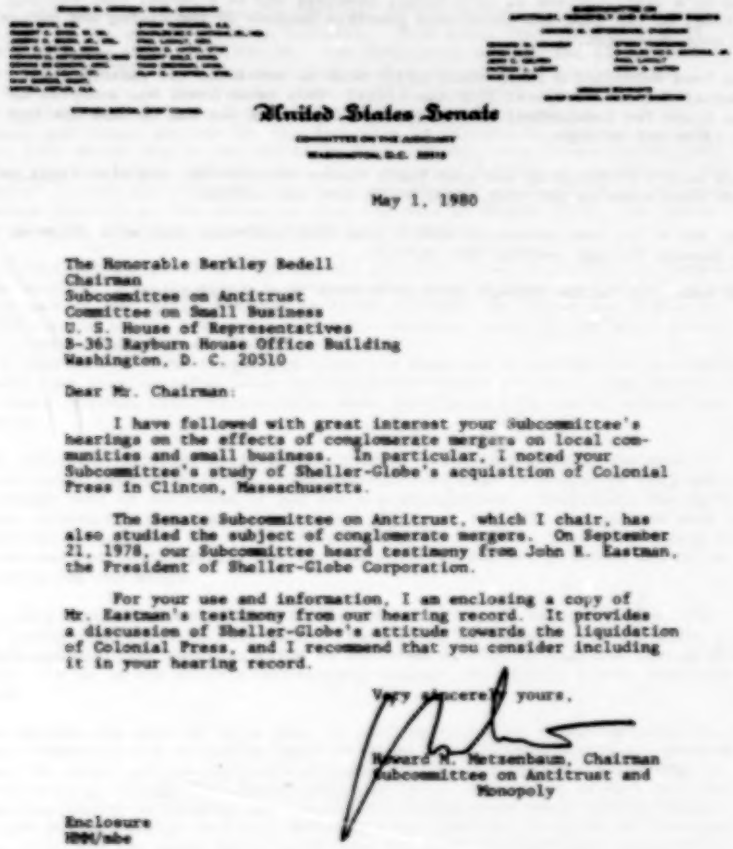
The Town submitted a recap sheet which made no provision for raising the overlay deficit on fiscal 1979 tax bills! This recap sheet was accepted by the State Tax Commission. The bills have been sent out and we have not had to raise the deficit.

From both a bookkeeping and cash basis manner of thinking, and also legal,we must make moves to get that $208,000.00 into our coffers.

Rep. Moore has been presented with a home rule petition, that will allow us to finance through bonding this deficit.

The town must follow through on this measure in a timely manner.

APPENDIX C.—LETTER FROM SENATOR HOWARD METZENBAUM TO CHAIRMAN BEDELL; RE THE LIQUIDATION OF COLONIAL PRESS



United States Senate

May 1, 1980

The Honorable Berkley Bedell
Chairman
Subcommittee on Antitrust
Committee on Small Business
U. S. House of Representatives
B-363 Rayburn House Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

I have followed with great interest your Subcommittee's hearings on the effects of conglomerate mergers on local communities and small business. In particular, I noted your Subcommittee's study of Sheller-Globe's acquisition of Colonial Press in Clinton, Massachusetts.

The Senate Subcommittee on Antitrust, which I chair, has also studied the subject of conglomerate mergers. On September 21, 1978, our Subcommittee heard testimony from John R. Eastman, the President of Sheller-Globe Corporation.

For your use and information, I am enclosing a copy of Mr. Eastman's testimony from our hearing record. It provides a discussion of Sheller-Globe's attitude towards the liquidation of Colonial Press, and I recommend that you consider including it in your hearing record.

Very sincerely yours,

Howard M. Metzenbaum, Chairman
Subcommittee on Antitrust and
Monopoly

Enclosure
HMM/mbe

STATEMENT OF JOHN R. EASTMAN, PRESIDENT, SHELLER-GLOBE CORP.

Mr. EASTMAN. May I introduce Mr. James Kline, who is secretary of the corporation and counsel.

Senator METZENBAUM. We are happy to have you with us this morning.

Mr. EASTMAN. My management and I appreciate the opportunity to speak here today on our experience with Colonial Press, a printing company which we formerly operated in Clinton, Mass., and which we closed in April 1977. I will describe the circumstances which led to that business decision. Also, I wish to relate our efforts to find a buyer for the business who would continue its operations. We have had the benefit of reviewing the prior testimony and, of course, we understand the focus of your interest.

I should like to say at the outset that we feel very strongly that Colonial Press benefited substantially as a result of its acquisition by Victoreen Instrument Co. in 1967 and by its having been a part of what later became VLN Corp. and Sheller-Globe Corp. While we could not prevent its failure, we did not cause it.

Colonial was a privately owned company until it was acquired by Victoreen, and no management changes were made. In fact, Mr. Smith, the former owner of Colonial Press, stayed on in active management until 1970 and was retained as a consultant for an additional 3 years. Almost all of his management team remained until the end. Their plans for expansion and upgrading of plant and equipment to keep pace with technological advances in the industry were carried out and supported by both VLN and Sheller-Globe Corp. Neither corporation bled Colonial, rather, both corporations supported it through large capital infusions, nearly $13 million by VLN and $2 million by Sheller-Globe for plant, machinery, and equipment as recommended by the resident management.

Colonial Press' only business was the printing and binding of books. Its customers were publishers of hardcover and paperback books, and it had no proprietary sales. Sales, earnings, and other pertinent data for the years 1960 through 1977 are presented on exhibit 1. As you will see, Colonial Press was marginally profitable in the years just prior to our acquisition in 1974. With the recession of 1975, it began to sustain increasing operation losses.

From the time of Sheller-Globe's acquisition until it was closed, we accumulated losses of $7.3 million.

EFFECT ON COLONIAL OF SHELTER-GLOBE TAKEOVER OF VLN

Senator METZENBAUM. Could we just take a moment at this point to verify that Sheller-Globe took over Victoreen in 1974? Was that it?

Mr. EASTMAN. Yes. VLN Corp., of which Colonial Press was an operating subsidiary——

Senator METZENBAUM. As you look at the figures you have furnished us, concerning Colonial Press, it indicates that they did not make a tremendous amount of money. But going back to 1960, they made $5 million, $850,000, $624,000, $697,000, $682,000, $793,000, $1,306,000, $1,136,000, $968,000, and $930,000. Victoreen took it over in 1970 or 1967?

Mr. EASTMAN. 1967.

Senator METZENBAUM. In the year 1967, they made $1,136,000. These are all pretax figures.

Mr. EASTMAN. Yes.

Senator METZENBAUM. Then what happens after that?

Then you get $968,000—down slightly from the previous year; $930,000 in 1971; 1972, they dropped to $458,000; 1973 is a pretty good year with $1,070,000. Then you come in and take over VLN in 1974—the year they have $669,000. The very next year in 1975, they have a loss of $2,368,000. Those figures to me say something. They say this little company was not making a lot of money, but it was providing jobs for 2,500 people?

Mr. EASTMAN. It had a maximum employment, I think, of some 1,600 people.

Senator METZENBAUM. In 1974, it employed 1,600. In that year, they made $669,000, pre-taxed, although it was still $514,000 after tax. Then the next year, 1975, they cut the employment down to 1,205. In that year, they lost $2,368,000. In 1976, I don't have the figures, but employment goes down to 988. Aren't those sort of significant figures? Don't they sort of say——

Mr. Eastman. They said something to us, Senator.

We bought this company and the merger was effective October 1. 1974. No changes were made in the Colonial management. No changes were made in Colonial's policy or sales organization or direction. No changes were made in their cash position. They were permitted to go on. Immediately they started reporting operating losses.

That said something to us. It took us more than a year with a taskforce of financial and engineering people in their to determine really what the problem was. If you will take a look at exhibit 3——

Senator Metzenbaum. I must apologize to you. I hadn't turned the paper open. Because I didn't extend it, the 1976 figure losses were $3,012,000, and for the first 6 months of 1977, $10,777,000. I didn't know I had to turn the paper.

I just wanted to be certain that the record was clear that all of it had been provided to the subcommittee.

Mr. Eastman. You understand that the last year includes losses on disposition; that the operating figure for that 6 months was $1,962,000. Footnote A indicates what part of that $10 million was operating loss.

Senator Metzenbaum. I see.

Mr. Eastman. If I may, I would like to refer you to exhibit 3. We found that until about 1968 or 1969, Colonial Press had not furnished any paper on which it printed its books but the publishers shipped in their own paper. The sales figures you will see in exhibit 1 were sales of the value added by the printing operation, in other words the publishers sent in the paper. Colonial Press did not make any charge for the paper. It simply added on its manufacturing costs.

Commencing in the late sixties, they commenced offering paper to their customers and carried large inventories. At the time we took them over, they had $3 million worth of paper stock. The period from 1972 to the business recession in 1974, there was a shortage of paper; everybody was on allocation. We noticed it in our paper products of our office products division; those years were quite profitable. If you had paper, you could get your selling price. If you will look at exhibit 3, and these have been adjusted to 1972 constant dollars, because we wanted to see what was the market share that these people are enjoying, and what the manufacturing business they were actually doing, the sales included profit on the paper they were selling.

You will see from 1967 down to 1974 they were not actually increasing in sales of manufacturing content, or value added. They were having a shrinking market share even during that period, and they didn't know it.

INDUSTRY TRENDS

Senator Metzenbaum. Isn't it a fact that up until 1974 the sales were sort of running reasonably constant—a little bit up between 1967 and 1974—and the manufacturing sales were down but not drastically down. They had slid a bit from about $25 million to about $20 million over a period of 7 years, but then when you people came in, both the sales and the manufacturing sales drastically dropped down to something in the area of $7 to $9 million by 1977. You can find this in table 3.

Mr. Eastman. These will follow the industry figures and the industry curve in the sale of books; it dropped off very sharply in 1974 and 1975.

Senator Metzenbaum. Let's see if that is the case.

I have here the book manufacturing industry trends. In 1974, the actual value of overall shipments, was $1.155 billion. By 1976, they were up to $1.332 billion. The elementary and secondary text sales were $598 million in 1974 and up to $640 million in 1976. The adult hardbound sales were $308 million in 1974 and up to $331 million in 1976.

Mr. Eastman. You are not looking at the deflated figures, Senator; those are the dollar sales. It is true that the price of books was constantly going up, but in unit numbers it was declining.

Senator Metzenbaum. Even taking the deflated sales, they are down 5 percent on that basis, and from 1974 to 1976, on the overall shipments, elementary and secondary text sales are down about 7 percent between 1974 and 1976; the adult hardbound sales are down about 7 percent between 1974 and 1976, but if we are to compare equals with equals, we must then compare the deflated figures with respect to Colonial Press. Actually, the falloff between 1974 and 1976 for your own company, with respect to sales, you went from about $27 million down to $10 million. That is actual sales, and that is a falloff of about 60 percent. With respect to manufacturing sales, you went down something in the area of $20 million to about $7 million, or a falloff of about 6–6⅔ percent. I am just giving rough figures, because I don't have the actual numbers on this chart; so that isn't comparable. I think you can't use 1972 dollars, because you are talking about Colonial Press' sales in actual dollars and not in 1972 dollars. Am I correct?

Mr. Eastman. You are using 1972 dollars to determine a trend in the manufacturing activity in the plant. If you don't deflate it, you don't take the effect of inflation out of the price, and you don't get any indication of unit sales.

Senator Metzenbaum. I guess the point you are suggesting is what happened to Colonial Press was not much different than what happened in the industry generally. It seems to me that in the industry generally their sales were up in actual dollars, not tremendously but relatively modestly, whereas, Colonial Press's were down drastically. I really think the question we are asking here is: Do some of these conglomerate mergers merely serve a negative purpose vis-a-vis the community's interest?

Here was a company that was making money up until somebody came along and bought it up and continued to make some money actually under VLN, not a lot, but made some, and then along came Sheller-Globe.

This company is a relatively small operation for it and very possibly it doesn't know how to run the business. I don't know if that is the basis or what, or perhaps it has a kind of indifference to this small operation, and hundreds of people wind up on the streets looking for jobs and a total community is decimated by reason of the closure of a major plant. This is the real interest that I think this subcommittee has investigating this occurrence.

COLONIAL UTILIZATION OF CAPACITY

Mr. **Eastman**. We understand your concern, and we share that concern. The only place we would suggest that the prior testimony you have taken in this matter is not accurate is there was not attention, nor support, or concern on the part of Sheller-Globe. I do not agree that we lacked management expertise. We have some very fine manufacturing people, and we knew enough about the paper printing and binding industry from our office products operation that this was not all that strange. What has been said that we didn't know how to run this business is not the case. But I would like to point out to you that this business had been, over the years, built up to a very large printing operation. It had a nominal capacity: 5-day-a-week operation of 27 million books a month. They were selling between 1974 and 1975 between 4 and 5 million books a month. We had high-speed binding equipment that could have bound as many as four different titles of average size books at a time. That equipment never ran during the 2½ years that we operated it. This is what they have done with their money; they have made capital decisions to expand but only in the book manufacturing segment of the printing business.

We find that Donnelly, Hall, Arcada, Western, and the others who are successful printers are now doing no more than 25 or 30 percent of their sales in book manufacturing. It was the book part of the business that was hardest hit in 1974 and 1975.

If I might read you from the U.S. Industrial Outlook for 1978, published by the Department of Commerce, it says:

> The U.S. book printing industry consists of approximately 650 plants whose 44,000 employees produce 1.5 to 2 billion books and pamphlets each year. The total number of books sold per annum has not increased appreciably since the early seventies, and this lack of growth has adversely affected book printers. The number of book manufacturing establishments has dropped 13 percent in the past decade.
>
> In 1967, the industry consisted of 744 plants, of which 76 had 100 or more employees and 8 had over 1,000 workers. By 1977, the industry was reduced to an estimated 650 plants from 744 with only four establishments having 1,000 or more employees. Despite this loss of 90 to 100 establishments over the period 1967 to 1977, industry employment has remained stable at about 44,000.
>
> Lack of growth in the number of copies printed, combined with excess press capacity, produced strong price competition and low profit margins for many printers in the timeframe 1967 to 1975. This period was also marked by a transition in technology.
>
> Changes in the market for U.S. books has had a significant impact on book manufacturers. Recent declines in unit sales of elementary and high school textbooks and subscription reference works, for example, were felt primarily by the large printers—250 or more employers—whose equipment was designed specifically for the production of books with very long print runs, frequent use of color, hardbound casing, and sewn bindings.

The Department could not have better described the condition of Colonial Press; that's what it was built to do as a large, expensive, high-speed facility that could have provided seven times the volume of hard-bound books that it could sell. It didn't suffer a loss of sales because of lack of sales effort. It suffered a loss of sales because there were no sales there to be made.

We got additional business during this period; we took business in at no profit or at known to be below our manufacturing costs to try to carry the business through so it could run.

Senator **Metzenbaum**. When VLN and you put in $13 million and then $2 million for capital infusions, what did the $13 million go for and what did the $2 million go for?

Mr. **Eastman**. I can't give you an itemization of it, but they expanded the new plant, called the Adams Street plant, which had the high-speed presses and binding equipment in it.

Senator **Metzenbaum**. You were going to bring the balance sheets with you and the P. & L. sheets.

Mr. **Eastman**. I had no idea until 5:30 last night that there was any interest in them, so I didn't bring them, but we can furnish them. I know that they spent something like $3 million on plant additions during VLN's time, and I think $8.5 million for most modern high-speed web presses and binding equipment and the associated capital items that go with those things. The $2 million we spent was largely to buy out the lease from the Smith family for the old plant, which was causing occupancy costs of something like $480,000 a year to Colonial Press.

By buying the plant and getting surrender of the balance of the lease, we put $2 million in to buy the plant from Smith and reduced our occupancy costs by $220,000 or $230,000 a year. In addition to that, we spent some capital money on the equipment that was in the older plant; namely, letterpress and old hot-metal equipment. As we moved items, we reconditioned them, and those amounts were capitalized. Most of what we spent was in expense of movement and plant rearrangement and that sort of thing. In general, that is where the money went.

BOOK VALUE OF COLONIAL

Senator **Metzenbaum**. How much did VLN carry this company for on its books and how much did you carry it on your books for?

Mr. **Eastman**. I was interested in Professor Briloff's written statement, because the Colonial Press, as I recall it, had a book value of somewhere around $10 million to VLN. VLN's total assets were $41 million. But because we were forced by the Accounting Principle Board opinion 16 and the Securities and Exchange Commission to account for this as a purchase, even though we exchanged our common stock for VLN's common stock, nevertheless because VLN had bought some shares on the open market, this accounting requirement said that they had to be treated as a purchase and we had to value the assets at the market price on the day of closing of the stock we issued, even though there was no cash changing hands. At that time, in late 1974, the market was in severe decline. VLN stock was down, and so was ours. It was still a fair exchange in terms of market value, but using that $20 million of book value VLN disappeared in our consolidation.

We got what we called negative good will. Instead of having good will on the books, we had a deficit in the acquisition, with the result that our corporate balance sheet looked much more highly leveraged than it would have been had we been permitted to take that in. This occurred in consolidation only. The subsidiary books were never changed. The tax base never changed. The assets of Colonial Press at the time of merger were somewhere around $9.5 to $10 million for the tax basis. Because of this accounting treatment and consolidation, they appeared on the consolidated Sheller-Globe Corp. books as $6 or $7 million less than that.

Senator Metzenbaum. Did you finally wind up selling it to a group of employees? What has finally happened with it?

Mr. Eastman. No; we thought we had it sold to a group of employees headed by Mr. Matthews, who had been president of Colonial Press. We brought him in there from W.A. Kruger Co.; he had formerly been with Donnelly. When we decided we were going to sell it, we offered it at an advantageous price in order to keep the business going, if possible.

Senator Metzenbaum. At that point what was it on your books for?

Mr. Eastman. Around $9 million, I think. On the Colonial Press's books it was $9 million.

Senator Metzenbaum. On Colonial's books for $9 million, but on Sheller-Globe's balance sheet, since it had a negative book value——

Mr. Eastman. $6.3 million at the time it was finally closed, that the accountant supplied to the transaction. So we had a curious result; we had a tax loss. The sale of the assets produced a tax loss because we were valued for tax purposes and shown on the subsidiary's books, but because of the absorption of this asset disappearance factor, the negative good will, on our consolidated statements it showed a book gain.

The best way I have been able to explain it to any shareholder is like this. A lot of shareholders don't understand it either. Suppose you bought a car for $5,000. For some reason you had to take it into your accounting system at $2,000. For tax purposes, you have a $5,000 base on it, but your books only show $2,000. Now if you sell it tomorrow for $3,000, you show a book gain. But what has actually happened? You have lost $2,000 of the $5,000 you paid for it, and that's what happened here.

Senator Metzenbaum. What happened——

Give me the numbers, if you would please, with respect to what happened. Did you liquidate the company or what did you do with it finally?

Mr. Eastman. We had it sold——

Mr. Matthews and, as we understand it, the Bantam Press were involved in it. There were some financiers in Boston with the First National Bank of Boston providing some financing; that was to have closed about the middle of April. We showed up the morning of the closing, and they announced at that time that they would not proceed. Up until that time all of us had been working. Our people had been working with their people and with the customers, persuading the customers to leave their printing plates and their open orders and that sort of thing with Colonial Press so that this group could take it over. When this folded up, of course, the customers all had to place their business elsewhere; and we shipped it out, so we eventually sold the assets to another company, which we understand has liquidated it.

Senator Metzenbaum. Let me get the numbers then.

You were carrying it on Sheller-Globe's books at about $6.5 to $7 million?

Mr. Eastman. No; it was included in our plants, property, and equipment accounts at a value of $6.5 million less than the original purchase price depreciated, which was on Colonial Press's books.

Senator Metzenbaum. What was that figure?

Mr. Eastman. About $9.5 million, as I recall.

Senator **Metzenbaum**. You were carrying it at about $9.5 million?

Mr. **Eastman**. On the Colonial books.

Senator **Metzenbaum**. I am not interested in Colonial books; I am interested in the Sheller-Globe books. I would like to know what happened to Sheller-Globe as a consequence of this transaction.

I am not quite clear on that; I understood the automobile transaction, but I don't understand the Sheller-Globe/Colonial Press transaction.

Mr. **Eastman**. That's what happened to us on that one.

Senator **Metzenbaum**. All right. Tell me what it was carried on your books at, what price you offered it to the investment group headed by Mr. Matthew's group, what price you finally sold it for in liquidation, and what happened to you vis-a-vis both your report to your stockholders, as well as the tax consequences.

Mr. **Eastman**. In summary, what happened to us was this: We suffered a tax loss of some $7 million. Not everything on Colonial's books, you see, was a force to be written down. Inventories and accounts receivable were carried on Sheller-Globe's books at normal cost. This so-called purchase discount at the time of the merger was applied only to plant, property, and equipment, so in the disposition, we lost on liquidation of inventories a substantial amount of money. On accounts receivable—and there is always some shrinkage in collection when you close a business—we lost some money. I would not be able to identify it separately, but here is the explanation that we have given to shareholders inquiring about it. The selling price of our assets was $3,600,000. Net book value of assets sold: $1,432,000. Pretax gains on sale of assets: $2,168,000. Less disposal costs from operations after April 30, 1977 and all other related costs and adjustments due to shutdown: $4.8 million.

Senator **Metzenbaum**. What portion of that was operating losses? Is $2,168,000 the figure you used? No; you said $4 million, did you not?

Mr. **Eastman**. That $4.8 million included the disposal costs. Between what was charged to operations in the operating statements and what was written off as asset losses on disposition, I can't tell you. I don't have anything that would show it.

Senator **Metzenbaum**. Of the $4.8 million, since that is a pretty significant figure, it was a good portion of that operating costs?

Mr. **Eastman**. Not much; I would think not. We were maintaining a force during the time we were trying to hold this business together for the buyers. We had a publisher's inventory in what we call the pick-pack, or customer performance operation where they ship books out; that continued for a time.

Senator **Metzenbaum**. Since the $4.8 million is such a significant figure, what were these disposal costs? What was included therein?

Mr. **Eastman**. Disposition of inventories, for example, of 25 or 30 percent on some items—like inks and paper stock and anything in process, of course.

Senator **Metzenbaum**. Those wouldn't be costs; those would be losses on disposition of inventory. Disposing of your inventory is not a disposal cost. There is a distinction; you and I would both agree to that.

Mr. **Eastman**. I can't quarrel with how you want to classify it, Senator. The only statement the financial people have given me on it is less disposal costs; that is, loss from operations after April 30, 1977, and all other related costs and adjustments due to shutdown.

Senator **Metzenbaum**. Is this gentleman part of your accounting team?

Mr. **Kline**. No, sir.

Senator **Metzenbaum**. Is this gentleman part of your accounting down of that. It is a rather unusual figure. We talk about a $3.6 million selling price; we talk about net book of your assets; but you sold for $1,432,000. The net book of assets showed a pretax gain of $2,168,000. Then we have a $4.8 million disposal cost, including operations, and you say very little of that is included in operations. It is rather difficult for us to comprehend what you are really saying; I think we do have some interest. I would like to go back now to where we were; on your books, you were showing the value of this company at $1,432,000, or $9.5 million; I'm not clear which is the correct figure.

Mr. **Eastman**. I missed the question. I'm sorry.

Senator **Metzenbaum**. I had asked how much you showed the value of Colonial Press to be on your books. I thought you had indicated something in the area of about $9.5 million, but then you say that when you sold it, you reported to your stockholders that you were showing the net book value of assets at $1,432,000, which is a rather significant difference. I am trying to get a clear picture in my own mind just exactly what this transaction was, and really what was its impact—who paid for your liquidation of this company and whether or not the American taxpayers paid for it in some way.

Mr. **Eastman**. We had a very sizable tax loss on disposal for tax purposes of $7.577 million. Our effective tax rate at the time was 48 percent, Senator, so there was a tax benefit, before investment credit recapture, of $3.636 million, charged against that investment credit recapture of $106,000. The net benefit in absorption of tax loss was $3,530,000, or 48 percent of our net tax loss. This reduced our effective tax rate for that year as a corporation to about 40 percent. It is normally 48, and it is this year.

Senator **Metzenbaum**. What price did you offer it to the Matthews group?

Mr. **Eastman**. $3.5 million; that included more assets than are involved in this $3.6 million. In this accounting treatment we are talking about fixed assets, but we had paper inventories and work in process, printing plates already printed, and things of that kind which were included in the sale.

Senator **Metzenbaum**. Was the sale one transaction for $3.6 million?

Mr. **Eastman**. No; Not the final sale. That was a sale of only what was left: the plant, the property, and the equipment.

Senator **Metzenbaum**. Who purchased the plant and equipment?

Mr. **Eastman**. That was sold to Salem Corp.

Senator **Metzenbaum**. What else did they get for the $3.6 million?

Mr. **Eastman**. The plant and equipment and took over the applicable mortgage debt on the plant.

Senator **Metzenbaum**. How much did Sheller-Globe show as a total loss on Colonial Press? You say you put in $2 million at one point. Was that a capital investment, or a loan, or how was that shown on your books?

Mr. Eastman. It was a capital investment in plant, property, and equipment for the Adams Street plant. We still have it; it is idle; it has a mortgage of $1.2 million on it. It has been written down, as I recall to $600,000 on appraisal and fair market value.

Senator Metzenbaum. You still own the plant.

Mr. Eastman. The old plant—the old gin mill they call it.

Senator Metzenbaum. Would you explain to me one part of your testimony that I don't understand. You show that you were carrying on your books the value of the assets at $1,432,000. You sold it for $3.6 million, and yet somehow you wound up showing a tax loss of $7.5 million. That is pretty good. How did you do that?

Mr. Eastman. Let me go through it again. This was not a pooling of interests and accounting treatment. If it had been, there would have been $41 million for plant, property, and equipment at book value of VLN pooled into the corporate total. Instead, since the accounting treatment insisted that the value be measured at the market value of the shares we issued at the date of closing, that totaled $20 million, because the stock was down to five or six or something like that. They said: You can't put on your books any more than the market value of that stock, and we have to write down your plant, property, and equipment to that figure. So we got what we thought was $41 million worth of net book value for $20 million worth of stock they said.

Senator Metzenbaum. This is Sheller-Globe vis-a-vis Victoreen, or Victoreen vis-a-vis Colonial——

Mr. Eastman. This is a consolidated company versus VLN and Sheller-Globe as prior constituent companies.

Senator Metzenbaum. All right.

Mr. Eastman. That created what was called a purchase discount. It is the reverse of a goodwill item that you normally see when you pay more than the book value of assets acquired. We apparently paid less than the value of the assets acquired; we are not credited with it. We had to apply a purchase discount which is, nevertheless, not effective to change the tax basis. We still depreciate it for tax purposes and carry it as a depreciated basis for tax purposes; that is, the $41 million worth of assets less normal depreciation, every year.

Now, on the disposition of any one of those, where you get the tax benefit, if it sold for less than the book value, as you would in any other asset, you get the tax benefit of having sold it at a loss, but because this purchase discount applied, when you recapture it, as you are then required to do by the accounting principles, we could get a book gain. The $5,000 car we bought they said was worth $2,000. We sold it for $3,000, so we showed a capital gain on the books, reporting to the SEC and our shareholders. We say we actually had a loss, and we had a tax loss.

APPENDIX D.—STAFF MEMO TO CHAIRMAN BEDELL; RE THE EFFECTS OF CHANGES IN THE COPYRIGHT LAWS ON THE BOOK PUBLISHING INDUSTRY

BERKLEY BEDELL, IOWA
CHAIRMAN
JAMES M. HANLEY, N.Y.
HENRY B. GONZALEZ, TEX.
RICHARD H. ICHORD, MO.
TONY P. HALL, OHIO
TOM STEED, OKLA.

DAN QUAYLE, IND.
OLYMPIA J. SNOWE, MAINE
THOMAS J. TAUKE, IOWA

[illegible]

[illegible]

United States House of Representatives
Committee on Small Business
Subcommittee on
Antitrust and Restraint of Trade
Activities Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

February 4, 1980

To: Hon. Berkley Bedell, Chairman

From: Mark J. Levine, Staff Assistant

Re: The Effects of Changes in the Copyright
Laws on the Book Publishing Industry

Mr. Chairman, during the Antitrust Subcommittee's January 31 hearing on the effects of conglomerate mergers on small business and local communities you requested that the staff of the Subcommittee look into the consequences of the expiration of a copyright law provision.

The provision in question requires that copyrighted materials be printed in the U.S. or Canada. This provision has been cited as being the chief deterrent against U.S. book publishers going overseas for their printing jobs. The provision is due to expire July 1, 1982.

Mr. Chairman, as the attached Wall Street Journal article of August 8, 1979 points out, the expiration of this provision will probably spur a rash of mergers in the book publishing and printing industry, with the subsequent loss of thousands of jobs.

Attachment

Wall Street Journal, August 8, 1979

Rash of Acquisitions May Hit Book Publishers With Expiration of Copyright Law Provision

8/8 By Gene G. Marcial p. 39

Heard on the Street

The little-advertised scheduled expiration of a U.S. copyright law provision in 1982 could cause significant changes in the book publishing industry.

The provision is the so-called manufacturing clause that for many years has protected domestic printers from massive overseas competition. It is due to lapse July 1, 1982, and the prospect could spur a rash of mergers and acquisitions in the industry.

The clause requires copyrighted materials to be printed or manufactured in the U.S. or Canada and has been the chief deterrent against U.S. book publishers going overseas for their printing jobs. Once the clause is eliminated, American authors and publishers will be free to have their materials "manufactured" or printed and bound overseas, probably at lower cost, and still enjoy U.S. copyright protection.

But the publishers' gains will be the U.S. commercial printers' loss. Publishers spent about $1.4 billion in 1978 for printing, according to industry analysts, and are expected to spend about $1.6 billion this year. The book printing industry is one of the nation's most labor-intensive industries, with about 45,000 workers.

"The industry, thus, is monitoring the issue very carefully," says Douglas Horner, executive vice president of the Book Manufacturers Institute, a trade group. The institute, representing about 75% of full-line book manufacturers or printers, is trying to develop data that will help indicate the damage foreign printers will do to domestic printers with the expiration of the clause.

The impact could be across the board, analysts say. The big commercial printers, such as R.R. Donnelley, ink suppliers such as Sun Chemical, and book paper suppliers such as P.H. Glatfelter, are likely to feel the loss of some business should the clause go, analysts say.

According to initial findings of a study commissioned by a trade group, about 40% of the total printing market will be vulnerable to foreign competition, principally Japan, Taiwan and Singapore.

"Industry insiders are fully aware of the major revolution that the book printing and publishing industry is about to undergo after mid-1982, although Wall Street analysts still have to focus on it," one Wall Street securities analyst contends.

Concern over the impact of the elimination of the clause, he says, is reflected in the interest that some book publishers have attracted, including McGraw-Hill, Macmillan and Western Publishing (which has agreed to be acquired by Mattel, the giant toy maker). The analyst says companies like them are expected to enjoy a bonanza in terms of much lower costs in printing overseas.

Book publishers don't normally have their own printing facilities. Most of their printing and binding is given to commercial printers. A recent study estimates that the loss in printers' receipts could exceed $500 million and that about 21,000 workers could lose their jobs.

BMI's Mr. Horner said unions in the industry have announced their intention to fight for the retention of the clause to save the jobs. However, some analysts expect book publishers and authors to counter such an effort and thus far there hasn't been any action in Congress aimed at retaining the provision.

Industry observers believe that by 1982, a growing number of mergers and acquisitions in the printing industry could occur.

In a recent speech before the International Book Printers Association, William S. Lofquist, printing analyst at the U.S. Commerce Department, explained why. Higher labor rates, he said, must be balanced by greater productivity, which will result largely from more capital investment in technologically superior equipment. "You've got to have the funds to keep up the pace, and this should provide an ideal climate for more mergers and acquisitions,'" Mr. Lofquist says.

Initially, foreign printers may seek only reprinting jobs, he said, but they are likely to push for more jobs with a high amount of intricate typesetting that don't have fixed time deadlines. "It would seem that technical, scientific and professional books would be possible candidates for foreign manufacture," Mr. Lofquist said.

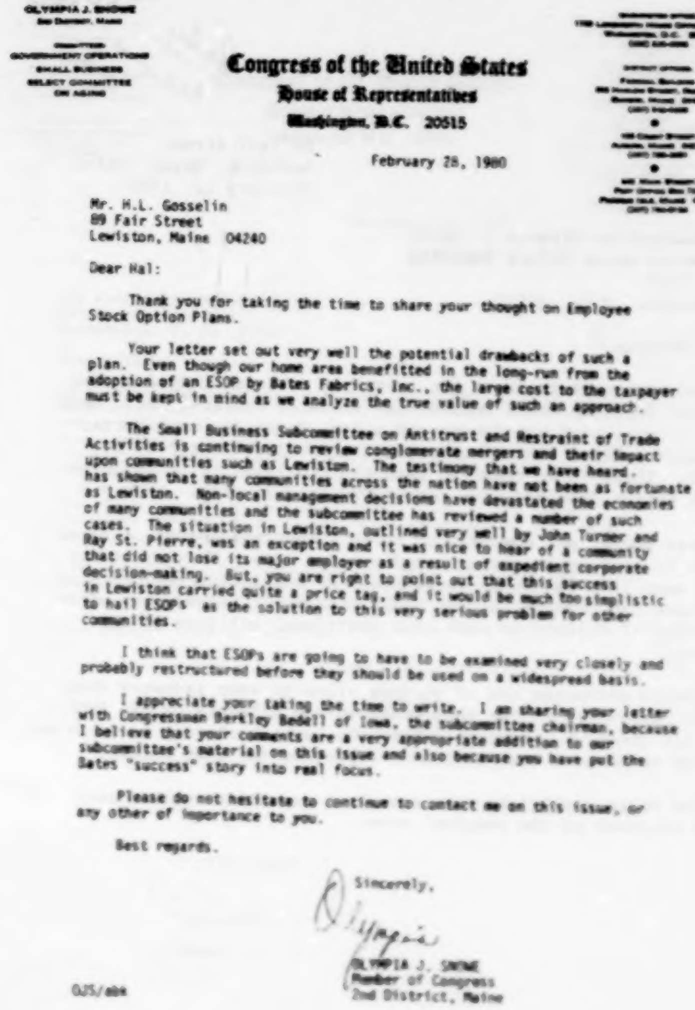
But specialization may provide a hedge against foreign competition, along with overseas expansion by the U.S. printers. On the side of the printers, there's considerable caution about the impact, but they prefer not to come out with hard statistics. "There's concern here and some studies are in the process, but we aren't prepared to comment on them," says Arthur Prine, a vice president at R. R. Donnelley.

Robert Ferris, vice president at Arcata Corp., a California-based commercial printer of books, is similarly cautious: "We are still sorting it (the clause's expiration) out."

On the book publishers' side, there's a low-key attitude. A McGraw-Hill spokesman downplayed the impact of the clause's removal. "We don't see American publishers switching any significant portion of their printing and binding business to foreign printers," he said. "There aren't any significant economies to be gained by such a move at this time."

Richard Udell, a vice president at Harcourt Brace Jovanovich Inc., a New York-based book publisher, says "we aren't thinking much about it; nobody is running around panting and asking, when will it come?"

APPENDIX E.—MATERIAL SUBMITTED BY HON. OLYMPIA J. SNOWE; RE THE BATES MANUFACTURING ESOP



OLYMPIA J. SNOWE
2nd District, Maine

COMMITTEES:
GOVERNMENT OPERATIONS
SMALL BUSINESS
SELECT COMMITTEE
ON AGING

Congress of the United States
House of Representatives
Washington, D.C. 20515

February 28, 1980

Mr. H.L. Gosselin
89 Fair Street
Lewiston, Maine 04240

Dear Hal:

Thank you for taking the time to share your thought on Employee Stock Option Plans.

Your letter set out very well the potential drawbacks of such a plan. Even though our home area benefitted in the long-run from the adoption of an ESOP by Bates Fabrics, Inc., the large cost to the taxpayer must be kept in mind as we analyze the true value of such an approach.

The Small Business Subcommittee on Antitrust and Restraint of Trade Activities is continuing to review conglomerate mergers and their impact upon communities such as Lewiston. The testimony that we have heard has shown that many communities across the nation have not been as fortunate as Lewiston. Non-local management decisions have devastated the economies of many communities and the subcommittee has reviewed a number of such cases. The situation in Lewiston, outlined very well by John Turner and Ray St. Pierre, was an exception and it was nice to hear of a community that did not lose its major employer as a result of expedient corporate decision-making. But, you are right to point out that this success in Lewiston carried quite a price tag, and it would be much too simplistic to hail ESOPs as the solution to this very serious problem for other communities.

I think that ESOPs are going to have to be examined very closely and probably restructured before they should be used on a widespread basis.

I appreciate your taking the time to write. I am sharing your letter with Congressman Berkley Bedell of Iowa, the subcommittee chairman, because I believe that your comments are a very appropriate addition to our subcommittee's material on this issue and also because you have put the Bates "success" story into real focus.

Please do not hesitate to continue to contact me on this issue, or any other of importance to you.

Best regards.

Sincerely,

Olympia

OLYMPIA J. SNOWE
Member of Congress
2nd District, Maine

OJS/abk

FEB 15 1980

Ackly
Ma

89 Fair Street
Lewiston, Maine 04240
February 12, 1980

Representative Olympia J. Snowe
Longworth House Office Building
Room 1729
Washington, D.C. 20510

Dear Olympia:

I read with much interest the newspaper article regarding the Federal Employee Stock Option Plan at Bates Fabrics, Inc. Needless to say, Lewiston-Auburn and all of Maine are much better off having Bates Fabrics operate with local ownership so to speak. There is no question that the availability of Employee Stock Option Plan did save some 1,000 jobs locally.

It does bother me, however, that the former management of Bates found it most advantageous under our tax laws. They wanted to walk away from the local situation. By convincing employees to purchase the company through ESOP, management walked away with millions of dollars in cash plus additional millions in tax losses.

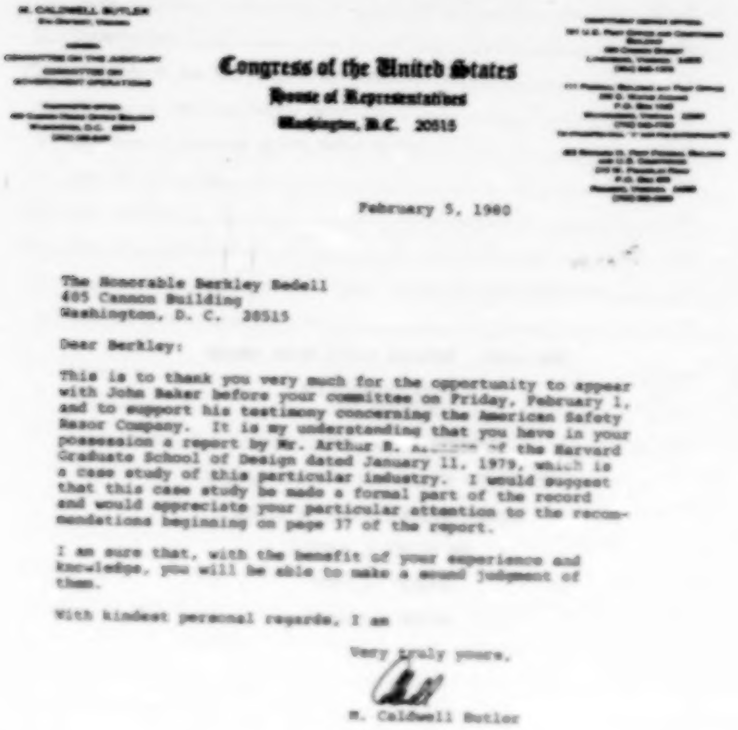
We should encourage use of various plans to save industry when at all possible, but we should discourage attempts to use ESOP and tax losses by absentee owners who have absolutely no interest in the welfare of communities or employees for that matter.

In the Bates case, jobs were saved but financiers walked away with millions of the peoples' money.

Sincerely,

H. L. Gosselin

APPENDIX F.—LETTER TO CHAIRMAN BEDELL FROM HON. M. CALDWELL BUTLER; RE AMERICAN SAFETY RAZOR CO.



M. CALDWELL BUTLER

Congress of the United States
House of Representatives
Washington, D.C. 20515

February 5, 1980

The Honorable Berkley Bedell
405 Cannon Building
Washington, D. C. 20515

Dear Berkley:

This is to thank you very much for the opportunity to appear with John Baker before your committee on Friday, February 1, and to support his testimony concerning the American Safety Razor Company. It is my understanding that you have in your possession a report by Mr. Arthur B. [illegible] of the Harvard Graduate School of Design dated January 11, 1979, which is a case study of this particular industry. I would suggest that this case study be made a formal part of the record and would appreciate your particular attention to the recommendations beginning on page 37 of the report.

I am sure that, with the benefit of your experience and knowledge, you will be able to make a sound judgment of them.

With kindest personal regards, I am

Very truly yours,

M. Caldwell Butler

CASE STUDY: AMERICAN SAFETY RAZOR COMPANY

A PAPER PREPARED FOR
PLANNING 220

COMMUNITY DEVELOPMENT FINANCE

DEPARTMENT OF CITY AND REGIONAL PLANNING

HARVARD GRADUATE SCHOOL OF DESIGN

FOR BELDEN H. DANIELS

JANUARY 11, 1979

ARTHUR R. CRYNSON

CONTENTS

I. Summary..i

II. Introduction..iv

III. Overview of the Razor and Blade Industry...............................1

IV. History of American Safety Razor..7

V. The Sale of American Safety Razor to Bic.................................9

VI. The FTC Challenge...12

VII. The Reaction...17

VIII. The Sale to Management...25

IX. American Safety Razor After a Year: Follow Up and Evaluation........34

X. Conclusion and Recommendations...37

Footnotes...42

Interviews..49

Bibliography..51

SUMMARY

This is a case study of the saving of the American Safety Razor Company (ASR) of Verona, Virginia. The story begins with Philip Morris wanting to sell its razor blade subsidiary, ASR, to the Bic Pen Corporation (BIC). BIC had just entered the highly concentrated United States' safety razor market. However, this proposed acquisition was stopped by the Federal Trade Commission (FTC). Due to this interference, Philip Morris decided that it would be easier and just as profitable to liquidate ASR that accounted for a mere 1% of total sales and two-tenths of 1% of total profits, than attempt to find another suitor. Philip Morris felt that it attempted to meet its corporate social responsibility to preserve 850 ASR jobs, but was thwarted in this effort by the FTC. The liquidation process proceeded quickly, and half the workers were terminated. During this critical period, the management of ASR was able to put together a financial package of public and private funds to purchase the company. This task was accomplished in the spring of 1977. The successful sale to management saved approximately 600 of ASR's original 850 jobs and almost one million dollars in tax revenue the company generated annually. To date, ASR has proved to be a viable and successful enterprise.

More specifically, Philip Morris had wanted to sell ASR because it preferred an investment that would yield a higher rate of return. Bic wanted to buy an operating company with a solid base in the razor blade market and the capacity to manufacture its disposable shaver. In late December, 1976, Bic reached a definite agreement for the acquisition of the American Safety Razor Division of Philip Morris, Inc., for approximately $19 million in cash and notes. But on February 9, 1977, the FTC challenged this acquisition on the

ground that it would be anti-competitive. Bic and Philip Morris vigorously disagreed with this viewpoint in light of the dominant position of one manufacturer, Gillette, in the razor blade market. On February 17, 1977, Bic terminated the agreement to purchase ASR, and Philip Morris acted to remove ASR as a competitor in the razor blade industry by beginning a gradual liquidation of the plant. Thus, there would be fewer competitors in the razor blade market.

ASR employees mounted an intensive protest campaign that included picketing the FTC. Sixth District Rep. M. Caldwell Butler and his staff, among others worked diligently to get the FTC to reconsider its opposition to the merger and to work out a compromise that all parties could agree on. The lines of communication had broken down by this time, however, and their efforts failed.

When the ASR management realized that ASR was to be liquidated, they set out to buy ASR. The ability to obtain financing was crucial to the purchase of ASR by its management. The management, aided by an investment banking firm, put together the necessary financial package: high-interest bank loans and low-cost public financing, supplemented by the nine managers' own capital. Politicians helped to arrange the government loan. After the layoffs, Augusta County, home of ASR, qualified as a depressed area for a loan from the Economic Development Administration, a Commerce Department agency. The E.D.A. Title IX grant to the State of Virginia was particularly crucial for management's financing arrangements.

As soon as management became unencumbered by its subordinate relationship to Philip Morris, it was able to capitalize on its new status to make positive changes within the new organization. Despite the employee cutbacks, bad publicity and substantial decreases in advertising, the company still returned a profit in 1977, and topped the 1976 profit level in 1978.

The ASR Company is one of many examples of subsidiaries acquired by conglomerates during the 1960's. ASR is like many other subsidiaries which are which are now being dropped by their parent companies. In some instances these divisions are unprofitable, or simply not providing the parent company with a sufficient rate of return. Sometimes these subsidiaries no longer meet the parent corporation's goals and objectives, or the conglomerate may just want to sell the division to raise cash. Whatever the reason may be, the futures of these shedded subsidiaries should be of particular concern if they are viable or potentially viable firms. For other firms to avoid the liquidation fate that ASR almost met, the FTC needs to coordinate its intervention in corporate acquisitions with such federal agencies as the Farmers Home Loan Administration (FHLA) and the Economic Development Agency (EDA) when the FTC investigates firms in economically depressed areas of the nation. By taking the economic as well as social implications of denying corporate acquisitions into account, the FTC can alert the EDA and the FHLA that a merger or acquisition may not be permitted. These two agencies, then, can work with the firm to seek alternative means to save it as in the case of the management buy-out that occurred at ASR.

INTRODUCTION

Disappointed with the profits shown by its razor division, Philip Morris, Inc. made a decision to withdraw from the razor blade industry. It could accomplish this goal either by liquidating the American Safety Razor Corporation or by selling the division. Although either course of action would be financially acceptable to Philip Morris, Inc. since it could realize approximately as much from the liquidation of its assets as it could from sale of the division, it elected to try to sell the division to preserve employment. Philip Morris negotiated a sale to the Bic Pen Corporation, but the Federal Trade Commission challenged the acquisition and Bic withdrew its purchase offer. Thus, Government intervention on the part of the Federal Trade Commission contrived to nix the acquisition. Although in establishing the Federal Trade Commission, legislators never intended it to be a vehicle for causing people to loose their jobs or for causing severe economic repercussions, that is precisely what happened in the American Safety Razor case.

It was another Federal agency, however, that helped to preserve the razor blade company as a viable business: The Economic Development Administration ("EDA"). With the EDA's assistance, American Safety Razor's management team was able to purchase the razor blade company. This paper presents a classic case study where private enterprise has resolved its problems with federal, state and local aid to save jobs so that employees remain taxpayers rather than tax liabilities. Although the company under discussion also utilized private sector financing, the keystone to the financing arrangements was a public sector financial vehicle.

The purposes of this paper are to: 1) examine the role these two Federal agencies played in the liquidation and re-organization of American Safety Razor; 2) examine the financial mechanisms used by the management group to purchase the razor blade company; 3) evaluate the success of the company from business and social viewpoints; and 4) draw conclusions and make recommendations relevant to retaining other mature industries faced with liquidation. To provide a perspective on this case study, an overview of the razor and blade industry in the United States will be presented in the first section.

OVERVIEW OF THE RAZOR AND BLADE INDUSTRY

The analysis of this case study must include an understanding of the state of the American razor and blade industry, its recent history, present conditions, and future prospects.

The Market

The market consists of razors and razor blades used in wet-shaving, including disposable shavers. Disposable shavers are substitutes for razors and blades and are priced competitively with replacement blades. The razor blade business is included in the broad category of Health and Beauty Aids. The industry utilizes a direct sales force structure which consists of individuals who are employed by their respective manufacturers. The only major producer in the industry that employs a sales agent is Wilkinson. Wilkinson uses Colgate-Palmolive as its sales agent and, therefore, the Colgate-Palmolive direct sales force sells Wilkinson's razor and blade line. Razor blade merchandising is primarily at the check-out counter. The razor and blade business is fragmented among eleven classes of trade, each serving a different purpose in the distribution and sale of the product. The eleven trade classes are grouped into three major categories that together represent the total domestic sales: food, drug, and mass merchandisers.

Barriers to entry into the United States razor and blade industry are substantial. In the last fifteen years only one firm has entered the market: Wilkinson Sword, an established English company with approximately $50 million in sales in the razor blade, gardening tool and fire control equipment businesses. Its entrance in the early 1960's was accomplished only with the assistance of Colgate-Palmolive whose establised toiletries distribution network enabled Wilkinson to place its razors and blades at retail. In order for a new entrant to become a substantial competitor in the industry, it must establish a distribution network which can place its blades in a sufficient number of retail outlets to meet competition where blades are sold.[1] BIC was able to enter the razor blade market because it already had a well-known product line in its disposable plastic molded products, i.e., writing instruments and lighters, a developed sales force, and existing nationwide business accounts. BIC used its technology in molded plastics to develop a disposable razor for an untapped segment of the market that would be receptive to this kind of convenience, i.e., a disposible razor. No other manufacturer had a disposable razor blade on the market.

Substantial advertising and promotional costs characterize the industry. In order to garner a significant market share, large advertising and/or promotion expenditures are required. The razor blade industry's priority objective is promotion selling. All trade factors use the techniques of feature price, advertising support and display. The largest percentage of purchases are made on promotional programs in most major accounts. Promotions ensure automatic distribution to retail stores, increased store inventory, trade advertising support, display support at point-of-sale, increased consumer buying, and increased brand awareness among retail personnel. There is great competition for promotional acceptance among all manufacturers. Due to the demise of the small retailer and the dominance of major chains in the drug and discount store industry, fewer accounts represent the larger segment of the industry's business. Furthermore, key accounts, selective in the number of promotions they run and items they select for promotion, began demanding a minimum of 21% profit on promotional purchases in 1977.[2]

Razor blade manufacturing, however, is not a highly technical process relative to other industrial processes, and patents do not appear to pose an impediment to entry. Furthermore, the materials (metals and plastic) used in the manufacturing process are readily available. Economies of scale are prevalent in razor blade production. Gillette manufactures all of its blades in one plant (+one billion blades) as did Bic for its world-wide razor business until 1978.[3] Economies of scale also exist in marketing and distribution, especially with regard to a multi-item product line. Consumer recognition of a trade name aids all products of a company. If the razor and blade producers also sell other personal products, the entire product line can be efficiently sold and distributed by their sales forces in only one stop at each outlet.

The Competitors

The United States market for razors and blades used in wet-shaving consisted of four firms until the entry of Bic in late 1976: Gillette, Schick, American Safety Razor ("ASR"), and Wilkinson. Each firm manufactures branded products, while ASR and Wilkinson also produce private label razor blades. Concentration in the production and sale of razors and blades is extremely high with the leading four firms (including private label sales) representing approximately 98.5% of total U.S. retail and wholesales sales (on both a dollar and unit basis). The approximate market shares of razors and blades in 1976 were as follows:[4]

Company	Percent of Blade Sales
Gillette	57%
Schick	21%
ASR	13%
Wilkinson	7.5%
Other	1.5%
Total	100%

Market shares for the top four firms remained relatively stable from 1970 through 1976, with Bic attaining a 1.2% share of the domestic market in 1976. During this same period, total retail sales of blades and razors realized an average increase of 8% per year.[5] Domestic razor and blade volume approximated 1.9 billion units and $385 million at retail in 1975, while factory shipments approximated $250 million, consisting of $34 million of razors and $216 million of blades.

The razor and blade market continues to be dominated by one company which has become synonymous worldwide with men's shaving, Gillette. In the United States, Gillette represented a 58% share of the market in 1977, producing and selling blades and razors worth $270 million at retail. In that year, razors and blades contributed 31% of Gillette's total company revenues of $1.6 billion and 71% of its net profits of $79.7 million. It is estimated that in 1978 Gillette had about a 60.5% share of the blade and razor market at retail, and strong growth in 1979 is predicted. This is in contrast to recent years in which Gillette's share of the U.S. blade market has remained essentially static. There are several reasons why Gillette increased it market share in 1977, and it is probably not attributable to ASR's business problems. Gillette has the lion-sized share of the razor blade market because of its advertising strategy of sponsoring numerous televized sports events that attract primarily adult male audiences.[6] Its increase in sports advertising in 1977 correlated with sales gains. Another factor leading to Gillette's sales growth in 1977 was the introduction of the Atra Automatic-Adjusting Twin Blade Razor and Cartridge. This product was introduced in mid-1977. By the end of the year Gillette reported that Atra was the "...best selling razor in the United States." In addition, Gillette had achieved success in 1977 with its disposable razor called Good News.[7] The Good News razor was first introduced in March, 1976 to blunt Bic's entry with its disposable shaver which had already achieved success in Europe.

Another factor in the razor and blade industry is Bic Pen Corporation. Societe BIC, a French company which owns controlling interest in the Bic Pen Corporation, purchased a razor blade company in Greece in 1973 in order to obtain the production and technological abilities for the manufacture of razor blades. Together with Bic's excellent production ability in plastic molding, this enabled Bic to develop a disposable razor.

The Bic Shaver, a light, one-piece, disposable, bonded shaving system, designed to replace the traditional razor and blade system, was introduced into Greece in September, 1974 and has achieved a 40% market share there. Introductions of the Bic Shaver in Italy and Austria during 1975 have captured 15 to 20 percent of the market, while shares approximate 10 to 15 percent in France, Belgium, Australia and New Zealand. Bic introduced its Bic Shaver in Canada in 1976, and in 1977 it had about 4% of the razor market and 60% distribution in that country.[8]

In July of 1976, Bic introduced the Bic Shaver to approximately 14% of the United States population in six North Central states where, in six months, it attained 50% distribution and 1.2% of the domestic razor blade market. Bic sold over 32 million Bic Shavers with factory value of $3.2 million in the last six months of 1976.[9] In 1977, the Bic Shaver was introduced nationally with a $9 million introductory advertising and merchandising campaign--the largest in Bic's history. This included a sampling program that reached 40% of all U.S. households, a major coupon redemption plan, extensive newspaper advertising, and 30-second television commercials.[10] Bic Shaver's share of the U.S. market is estimated at 3% for 1977.[11] Unlike the rest of the industry, Bic only manufactures a disposable shaving product. According to David Furman, Bic's Advertising director:

> The rest of the industry is fighting the wrong war. Disposables have changed the nature of the business, but other companies are fighting with old tools. Disposables are successful not because of advertising or price. Disposables are a cultural wave that is sweeping the world. They are the hallmark of a mass culture. ASR is not really in disposables. Wilkinson and Gillette's hearts aren't in disposables.[12]

In addition to disposable shavers, Bic manufactures and sells writing instruments, disposable butane lighters, and pantyhose. Writing instruments represented 51% of Bic's sales in 1976 and much of the profit, while its disposable lighters accounted for 43% of Bic sales and 32% of profit in 1976.[13] Its manufacturing facilities and corporate headquarters are located in Milford, Connecticut although Bic did not manufacture razors domestically until 1978. In 1975, Bic's total sales reached $93 million. Bic had 1976 net profits of $10 million, or $1.55 a share, on sales of $122.8 million, up 33% in all categories.[14] Its successful business philosophy is to produce disposable consumer products that are suitable for mass production and can be merchandised through its existing channels of distribution. While Gillette's corporate philosophy is to sell to the upper middle class and let products percolate down, Bic, on the other hand, is devoted to the mass market which is very interested in the price-value relationship.[15] Bic manufactures products used frequently by many people where form and function are important.

The threat of Bic as a major new competitor in the razor blade industry resulted in defensive responses. In anticipation of Bic's entry into the domestic market in 1976, Gillette expanded its product line to include Good News, a disposable razor to counteract the appeal of Bic's disposable entry. Gillette believed that,"Whatever Bic's success might have been in the U.S., it will be considerably less by coming on the market after Good News. Similar situations will exist in other markets where Gillette disposable razors will be introduced at the same time or ahead of Bic."[16] ASR, also perceiving Bic as a possible threat, stated in its Five Year Plan (1976-1981) that, "...the entrance of Bic into the U.S. shaving blade market will impact heretofore relatively stable company share positions."[17]

American Safety Razor is the third largest domestic manufacturer of razor blades and the largest private label razor blade manufacturer in the United States with 65% of private label sales. Private label blades are razor blades made for large retailers such as drug chains that sell the blades under their own brand name. Its products account for approximately 11% of the $385 million razor blade industry, and its private label business puts its market share at 13%. ASR's brands include Personna, Gem, and Flicker, a compact-shaped women's shaver. In 1976 it had pre-tax earnings of $1.6 million on sales of $42.4 million.[18] ASR will be discussed in more detail in the following sections.

HISTORY OF AMERICAN SAFETY RAZOR

Although ASR will be discussed in more detail throughout most of the rest of the paper, a brief overview of the company's history will be given here.

American Safety Razor Company is the oldest extant blade manufacturer in the United States. It was 1875 when the Kampfe Brothers of New York City introduced the Star, the first safety razor. The blade was of heavy forged steel and the design of the razor won international awards for craftsmanship. Twenty-three years later a Kampfe employee, Jerry Reichard, founded the Gem Cutlery Company whose principal product was the Gem Razor, one of the most famous razors and blades developed in America. Several years later, Reichard formed the Yankee Company and manufactured razors and blades under that name. In 1905, the Yankee Company name was changed to Ever-Ready. In 1919, Gem, Star, and Ever-Ready razors and blades were consolidated with the formation of the American Safety Razor Corporation, chartered under the laws of Virginia. The manufacturing operation was located in Brooklyn, New York. The product line was expanded to include surgical blades and handles for hospitals in 1935. In 1954 the Company moved to Verona, Virginia.

ASR was acquired by Philip Morris Incorporated in May of 1960 in a transaction valued at about $22.5 million at the time.[19] Philip Morris Incorporated is a Virginia corporation with its principal place of business located at 100 Park Avenue, New York, New York. Philip Morris once had hoped that ASR could challenge Gillette and Schick for dominance in the razor blade market with its Personna, Gem, Blue Star and the Flicker women's razor. It made investments in new machinery during the 1960's and early 1970's.

There have been many industry firsts developed by ASR. In 1963, the Company was the first manufacturer to produce a stainless steel coated blade--Personna. Six years later, Face Guard, the first guarded blade ever marketed, was introduced. In 1970, Personna 74 double edge and injector blades, made of tungsten steel and advertised as being "the sharpest, longest lasting blades made," began production. In 1971, ASR introduced Flicker, the first disposable razor ever developed exclusively for women and featuring a unique wire-wrapped blade. It is the number one women's shaving instrument in the nation. In 1973, ASR introduced Personna Double II, the first shaving instrument with two bonded blades on two sides. ASR also developed two razors for those persons who prefer injector and double edge blades: the Personna Injector II produced in 1972, and the Double Edge II with two double edge blades welded together produced in 1975. ASR became the leading supplier of industrial cutting edges for clothing, carpet and other uses, boasting a product line of several hundred different types of cutting edges. With sales increasing 900 percent from 1969 to 1976, industrial products represent the fastest growing segment of ASR's business. ASR became the second largest supplier of surgical blades and a major supplier of private label razor blades. With an advertising budget one-tenth the size of Gillette's, however, ASR never captured more than 13 percent of the total market.[20]

Philip Morris changed its plans to build ASR into a formidable marketing company when it acquired control of the Miller Brewing Company in 1970, and decided to concentrate its investment capital in beer and tobacco. It found that selling cigarettes and selling razor blades were two different businesses, while cigarettes and beer had a great deal in common. Philip Morris was only concerned with keeping ASR marginally profitable. ASR amounted to barely 1% of corporate revenues. By 1974, Philip Morris wanted to get out of the razor blade business entirely.[21]

Although Philip Morris made substantial investments in research and development and innovation from 1960 through 1974, its ASR division failed to dent Gillette's market share. This was due to three industry characteristics: patents are non-existent; the technology is easy to copy; and marketing, advertising, and distribution strengths are essential determinants for success.

THE SALE OF AMERICAN SAFETY RAZOR TO BIC

Acquired in May of 1960, the Razor Division of Philip Morris had operating revenues of approximately $42.3 million, and operating income, i.e., profit before taxes and interest, of approximately $1.5 million in the calendar year 1976. Its domestic sales of razors and blades amounted to $29.5 million. Philip Morris' investment in the Razor Division amounted to approximately $22 million, and the return on this investment, at approximately 4% was less than the carrying cost of the assets.[22] Even though Philip Morris was making $1.5 million annually from ASR, it could make more if it sold ASR and put the money into other things. The after tax return was not as much as would be earned by tax-exempt municipal bonds. By comparison, the return from Philip Morris' $4.5 billion investment in tobacco and beer approximated 15%.[23]

The senior management of Philip Morris had decided that with Philip Morris' growth in other areas, its participation in the razor blade business was not material to Philip Morris' profitablility and growth. Philip Morris' experience in the business had been unsuccessful after seventeen years of effort. The

best copy available

industry, which produced retail sales of approximately $385,000,000 annually in 1976, was dominated by the Gillette Company. Any attempt to increase the Razor Division's market share would have required a sizeable investment on which Philip Morris would not realize an adequate return. Consolidated operating revenues and consolidated operating income of Philip Morris in 1976 were $4,293,782,000 and $634,539,000, respectively. Consolidated assests of Philip Morris at December 31, 1976 were $3,582,209,000.[24] Thus, Philip Morris believed that its time and efforts would be more profitably spent in its other lines of business and that it should realize what it could on its investment in the Razor Division and concentrate its efforts on its primary source of revenues and income: beer and tobacco.

Dissatisfied with the performance of the Razor Division, Philip Morris held discussions with several prospective purchasers. For example, in 1974 discussions were had with British Match Corporation; in 1975 with Kaman Corporation, Regulus International Capital Corporation, Sterling Drug, Inc., The Wonder Corporation, and with a group of individual investors; and in 1976 with American Home Products Corporation, Carter-Wallace, Incorporated, The Coca Cola Bottling Company of New York, Inc., and Shulton, Inc.[25]

Philip Morris took the position in connection with all discussions that were held with prospective purchasers that the Razor Division would not be sold unless two conditions were met: the jobs and benefits of the employees were protected and Philip Morris received book value for the Razor Division. Only Bic Pen Corporation, 47% owned by France's Societe Bic, gave assurances in this regard. Bic agreed to maintain the existing pay scales and to offer a benefit package similar to the one under Philip Morris. The specifics of the benefit programs that Bic and Philip Morris agreed to were that: 1) the employees present rates of compensation would continue after the sale; 2) Bic would establish a package of insurance and benefit plans comparable to those which have been provided by Philip Morris; 3) Bic would provide a new pension plan that was comparable to the Philip Morris Retirement Plan and that would give full credit for employment at ASR; and 4) the Deferred Profit Sharing Plan would not be continued but employees would be offered several choices for receiving the money that was held for them in the pension plan.[26]

Bic had sought to acquire a domestic facility for manufacturing disposable razors--its only shaving product--through its ASR acquisition. The Bic Shaver was being imported from Greece and had just entered the United States market during the summer of 1976. Bic was buying the technology and distribution network of ASR. With ASR, Bic, intending to become a major factor in the razor blade industry, would obtain a full line of blades and would gain a 13% share of the $385 million domestic razor blade market. While ASR was small to Philip Morris, it represented a major acquisition for Bic. Although not much compared to Gillette's nearly 60% market share, ASR would give Bic, with about a 2% share of its own, a sturdy base on which to build, and put Bic in a far stronger position to challenge Gillette than either ASR or Bic had held separately. According to Robert Adler, president of Bic, "The biggest are always vulnerable... With flat growth in the marketplace, an added share of the market must come out of someone's hide--and that means Gillette."[27]

On December 30, 1976, Philip Morris entered into an agreement for Bic to purchase the assets and good will of the American Safety Razor Division of Philip Morris for $19 million. Under the agreement, Philip Morris was to receive $4.1 million in cash and a $15 million promissory note payable over twelve years from Bic. The interest rate was set at 6½% per annum from January 1, 1977 to December 31, 1988. The formal closing of the contract was scheduled for January 31, 1977.[28]

Bic had plans to run ASR as an autonomous subsidiary. It announced that ASR would manufacture the Bic Shaver, although the shaver would be sold through Bic's sales force.[29] Since the Bic Shaver was a single-blade disposable razor and Gillette's Good News was a twin-blade disposable, it remained to be seen whether Bic would utilize the twin-blade production technology of ASR and market a twin-blade Bic Shaver.

The acquisition of the Razor Division of Philip Morris by Bic, however, was never consummated.

THE FTC CHALLENGE

The Federal Trade Commission (FTC) lawyers learned about the proposed sale of the assets and business of ASR to Bic through the Wall Street Journal and decided an investigation was warranted. Bic and Philip Morris did not notify or seek the advice of the Department of Justice or the FTC before entering into the acquisition agreement.[30] Charging that the acquisition would violate Section 7 of the Clayton Act (15 U.S.C. Section 18) and Section 5 of the FTC Act (15 U.S.C. Section 45), the Commission issued an administrative complaint against Bic and Philip Morris on February 9, 1977. This complaint proposed that the acquisition would eliminate actual competition between Bic and ASR in the production and sale of razor blades, diminish the likelihood of future deconcentration in the razor blade market, and eliminate potential competition between Bic and manufacturers of razors and blades, including ASR.[31] The FTC contended the sale would reduce the number of razor blade manufacturers from five--Gillette, Shick, Wilkinson Sword, ASR and Bic--to four. In the eyes of the FTC, the more companies that make razor blades, the better. They had to preserve competition.

The FTC viewed Bic and ASR as direct and substantial competitiors in the highly concentrated U.S. razor blade market and also saw Bic as a significant potential competitor in the production and sale of razors and blades. The proven success of Bic as a producer and marketer of disposable products was a key factor in the FTC's decision.[32] Although Bic had only recently entered the domestic razor blade market, its impressive track record in foreign markets, its ability to enter new markets quickly, and its effectiveness in building its pen and butane lighter sales in the U.S. influenced the FTC to intervene in the sale. The FTC viewed Bic as the most likely company to develop into a competitive force capable of competing with the four major domestic razor blade companies. Manufacturers had perceived Bic to be a competitor, and had modified their behavior in defensive maneuvers in anticipation of Bic's U.S. entry. The FTC was of the opinion that Bic's 1.2% share for 1976 substantially understated Bic's present and future significance as a competitor.[33]

Critics of the FTC action reasoned that Bic was not an established firm in the United States since it did not manufacture in the United States, did not have national distribution, and its only product was a disposable razor. They felt that Bic was essentially a disposable lighter and pen company.[34] Proponents of the merger argued that Bic's acquisition of ASR would have created a stronger challenge to Gillette's dominant market share, promoting more competition rather than less in the razor and blade industry. They pointed out that Philip Morris intended to get out of the blade business regardless of whether ASR was sold. Thus, with or without the sale, only four companies would comprise the razor blade industry. Bic was a logical buyer because it ranked fifth in the industry in market share and its purchase was preferable to none at all. Furthermore, the FTC's interference guaranteed that Gillette would increase its dominance in the market. And that, they submitted, contradicted the very reason for the FTC's existence. They maintained that the FTC's action was not helping competition but was creating unemployment. The sale of ASR to Bic would preserve jobs, income, and personal dignity for over 800 families.[35] The problem with the proposed acquisition, according to the FTC, as reported in the press, was that...

> 'Once you say "sure" to a merger in a highly concentrated industry like this one, where do you stop?...If Bic, and ASR and Schick all merged, that would put all of them in a stronger position with Gillette. You'd have just two companies, one with 60 percent of the market and the other with 40 percent.'[36]

The FTC maintained its position was supported by the Supreme Court which held that even a slight increase in concentration in an already concentrated industry was legitimate cause for concern on the part of an anti-trust agency.[37]

The complaint's contemplated relief included the cancellation of the sale between Bic and the Razor Division of Philip Morris, the divestiture of all ASR property and assets owned by Bic, the prohibition of Bic acquiring another company in the razor and blade business for ten years without the FTC's prior approval, and the requirement of immediate notification to the FTC of decisions to dispose of any of Philip Morris' razor and blade assets, along with the identities of the purchasers. Furthermore, the FTC would require Bic and Philip Morris to file compliance reports with the FTC.[38]

At the request of the staff of the FTC, the formal closing of the contract was postponed from January 31 to February 11, 1977. On February 10, 1977, Bic announced that it had agreed with the FTC to a postponement of twenty days for the consummation of its proposed acquisition of ASR.[39] During the course of the FTC's examination, the Executive Vice President of Philip Morris U.S.A., Clifford H. Goldsmith, signed an affidavit stating that Philip Morris had made a firm decision to withdraw from the razor blade business and would liquidate the Razor

Division if the Bic acquisition was disallowed.[40] This stance was encouraged by those who wanted the sale to occur because it strengthened Philip Morris' position with the FTC, but they did not think Philip Morris would follow through on its liquidation position.[41] To withdraw from the razor blade industry, Philip Morris could either liquidate ASR or sell the division. Either course of action would be financially acceptable to Philip Morris, for it could realize about as much from the liquidation as it could from the sale of ASR. Philip Morris was confident that it could realize on liquidation of ASR approximately $5 million in cash the first year and an additional $10 million within two years.[42] Sale to Bic or liquidation "...we win either way," said a Philip Morris spokesman. Philip Morris elected to try to sell in order to guarantee the employment of ASR employees.[43]

In mid-February, 1977, the FTC sought a temporary restraining order and a preliminary injunction, as authorized by Section 13 (b) of the FTC Act, 15 U.S.C. (Supp. V) S 53 (b), requiring Bic, if it consummated the acquisition, to hold the business and assets of ASR separate from its own during the pendency of the administrative proceedings.[44] While the FTC asked the U.S. District Court for the Southern District of New York to review the underlying bases for the FTC's complaint and to determine whether an injunction would be in the public interest, the FTC, rather than the Court, would determine any violation of the anti-trust laws. That adjudicatory function, vested in the FTC, was subject to judicial review only in an appropriate court of appeals.

The FTC wanted a hold separate order to maintain ASR as an active competitor and to preserve its future viability as an independent entity. Intending to manufacture the Bic Shaver at the ASR plant, Bic planned to introduce additional machines to ASR and the FTC wanted to facilitate future severability through a hold separate order. The FTC reasoned that a decrease in production of ASR products could occur if Bic chose to emphasize production of the Bic Shaver at the ASR facility, and that a hold separate arrangement would preserve the production of the ASR product line. In addition, the FTC decided that in order to maintain the attractiveness of ASR to prospective purchasers in the event of a divestiture order, ASR's advertising and promotion expenditures, as well as its personnel, should be maintained.[45] Bic saw the FTC's intervention as hurting competition. Referring to the FTC's request that the federal court order the assets and business of ASR to be kept separate from Bic's pending the outcome of the FTC's study of the proposed merger, a spokesman for the firm commented: "We tried to buy a race horse to speed up our entry into the shaver business. Then the FTC tried to tie one of its legs and there is no way you can enter a race horse that has three legs."[46] The FTC action according to Bic's David Furman, left Robert Adler, President of Bic, "very discouraged with bureaucrats...who don't know what's going on outside their own offices."[47]

A hearing on the preliminary injunction was scheduled for February 23 in the U.S. District Court for the Southern District of New York with Judge Lawrence Pierce presiding. While meeting with FTC lawyers in Washington, D.C. in an effort to get approval for the acquisition, Marcel L. Bich, owner of the French parent of Bic, was asked by the FTC to agree to divest himself of ASR branded names (Personna, Flicker and Gem) within two years of the sale. Mr. Bich agreed to these terms on the condition that the FTC would agree that the brands would be sold only if Bic received a "reasonable" offer for them. Not allowing the word reasonable to be a part of the agreement, the FTC caused Mr. Bich to declare that he would be "buying a lawsuit."[48]

On February 17, 1977, the agreement by which Bic would have acquired the assets and business of ASR was terminated because Bic was unwilling to become involved in litigation with the FTC. To fight the FTC would mean interminable delays, heavy legal and transactional costs and uncertainties as to the outcome. In addition, one might speculate that Philip Morris did not want to jeopardize its chances of winning another federal case involving a larger subsidiary, Miller Brewing. The following statement was issued by Philip Morris:

> 'We believe the transaction should not have been challenged by the FTC. We believe the proposed acquisition was proper and would not have been anti-competitive--but rather, would have increased competition in the razor blade industry in this country...Philip Morris believes that the FTC is wrong, but nevertheless, the transaction has been terminated because of the inevitable delays and attendant uncertainties which would ensue in the litigation with the FTC.'[49]

A week later on February 25, the United States District Court for the Southern District of New York filed a consent order of dismissal. This ordered the proceeding of the FTC versus Bic Pen Corporation and Philip Morris, Inc. dismissed without prejudice.[50]

THE REACTION

Bic's decision not to acquire ASR prompted Philip Morris Inc. to begin to gradually phase out operations of its ASR plant. Philip Morris believed that it could realize almost as much from a liquidation of ASR as it could from the sale to Bic. About a third of ASR's 850 employees were terminated on February 25, 1977, as three shifts were cut to one. Morale, production and sales dropped with the termination of the acquisition.[51] Five product lines that accounted for almost 30% of ASR's projected annual production were dropped immediately: Double II, Lady, Injector II razor set, Face Guard and Double II razor set. Production of Flicker was cut by 66% while production plans for single edge razors, including Gem and Personna, were cut by 50%. However, private label, industrial and surgical brands continued at full production.[52]

By February 28, 1977, an additional 20% of the direct-labor work force was laid off and many management and salaried employees were terminated.[53] All advertising of ASR branded razor blade products had been cancelled by Philip Morris the week before. The sales force was cut from 80 to 30 persons. However, when the intent to liquidate if the sale was blocked was registered by the President of Philip Morris in an affidavit submitted to the FTC, it was considered an empty threat by FTC lawyers.[54] Ronald Dolan of the FTC stated:

> 'Well, I guess you could say I was somewhat cynical about Mr. Goldsmith's intentions. You develop a very cynical posture in this job. You hear alot of stories here as people try to defend their actions. You learn to discount alot of them.'[55]

Union and public officials in Virginia, as well as employees of ASR, began working hurriedly to pressure the FTC for a reversal of its intent to block ASR's acquisition by Bic. Both Philip Morris and Bic indicated that if the FTC withdrew its opposition ot the acquisition, they would proceed with the sale on the already negotiated terms. Bic's immediate interest in the sale, however, would not last longer than three months.

It appeared that the future of ASR rested on political action. The employees set up a seven-member ASR employee protest committee. Members of the Virginia Gerneral Assembly, Governor Mills E. Godwin, Jr., Virginia's ten U.S. representatives, and its two senators received releases from Philip Morris about the termination of the acquisition. Marcel L. Bich formally requested the Governor of Virginia to intervene and to provide any assistance he could to help the sale of ASR continue. The request was made in a telegram.[55] ASR employees conducted a protest campaign of writing and telephoning local, state and national political leaders, including President Carter, to bring political pressure against the FTC. The employees floated petitions, garnering over twelve thousand signatures. The Augusta County, Virginia Board of Supervisors unanimously adopted a resolution protesting the FTC's ban of the sale of ASR to Bic.[57] They tried to meet with the President in hopes he would intervene and force the FTC to rescind its opposition to the sale.

Every politician in the Shenandoah Valley expressed concern and promised action. [58] There was a flurry of political activity aimed at keeping ASR open. State Senator J. Marshall Coleman conferred with U.S. Representative M. Caldwell Butler in Washington, D.C., where they met with representatives of Bic and Philip Morris. Del. A.R. Gisen Jr., Senator Coleman and Del. Erwin S. Solomon met with Governor Mills E. Godwin to discuss the ASR situation with Earl Shifflett, Secretary of Commerce and Resources, and Frank Alspaugh, Director of the Division of Industrial Development for Virginia.[59] Official opposition of the FTC decision was announced by the Staunton City Council, the Staunton-Augusta County Chamber of Commerce, the Augusta County Board of Supervisors and area representatives in Richmond, Virginia and Washington, D.C.[60]

Sixth District Representative M. Caldwell Butler, in particular, devoted countless hours to the task, trying to get the FTC to reconsider its opposition to the sale and to find a compromise that all parties could agree on. Congressman Butler kept in constant touch with Philip Morris and Bic officials and the FTC. However, it was virtually impossible for outside interests to contact Commission members until the pending matters had been resolved or dismissed. The FTC was in the anomalous position of being both judge and prosecutor. Frustrated by the inaccessibility of the FTC, and criticizing the FTC for a lack of flexibility, Congressman Butler believed that the FTC wears:

> "...too many hats. Between its rule-making function, its enforcement function and its adjudicative function, something has to be done. The idea of not being able to talk to the prosecuting attorney just because he's got a case is an awfully difficult situation. When you can't talk to

public officials, there is something wrong with the system."[61]

At the insistance of Congressman Butler, Bic, Philip Morris and the FTC submitted a second motion on March 1 to waive the 30- ay waiting period after the consent order of dismissal before the case could be discussed with the FTC Commissioners.[62] With that motion approved, Representative Butler could meet with the Commissioners to ask them to review the Bic acquisition in light of the new circumstances--ASR being liquidated. Rep. Butler also arranged a meeting between the employees and Virginia's ten congressmen and two senators.

On March 2, a caravan of thirteen buses with over 500 disgruntled ASR employees and supporters from the Staunton, Virginia area journeyed to Washington, D.C. to picket the FTC, a first in FTC history.[63] The protest against the FTC was neither a union nor a management venture, but an employee effort. The Augusta County, Virginia citizens also took their plea for help to change the FTC's mind to Capitol Hill and the White House. They felt powerless to influence corporate decisions and federal regulatory actions that could eliminate their livelihoods.[64] Directing most of their wrath at the FTC, they hoped their trip would bring home to the FTC the human issues and hardships that would develop if ASR were liquidated.[65] It was a final effort to persuade the FTC to reverse a decision that could end 850 jobs. FTC Chairman Calvin Collier hinted that Philip Morris had backed the demonstration as a ploy to extract a favorable deal from the agency. Mr. Collier had said that "...all of us here in the law enforcement business are under constraints that others are not. We can't point fingers. But the FTC did not order anyone to close that plant. That was a company decision!"[66]

The 500 demonstrators, however, apparently made an impression because the FTC agreed to reconsider its decision on ASR. Senator Harry F. Byrd, Jr., Representative M. Caldwell Butler, State Attorney General Anthony Troy and employee representatives met with FTC staff members in the morning of March 2 and with the FTC Commissioners in the afternoon.[67] This meeting, which explained the economic importance of the plant to the Staunton-Augusta, Virginia area, was arranged by former State Attorney General Andrew P. Miller. The employees presented a petition with 12,000 signatures protesting the FTC action to the Commissioners.

Owen Johnson, the chief counsel of the FTC Bureau of Competition, had not known of the FTC ever being picketed. He said that ASR was the first case in which a business would close because of FTC action.[68] FTC officials suggested a way that ASR might be sold, without again encountering FTC opposition. Owen Johnson stated that the "failing company doctrine" might apply to ASR. In order to take advantage of that defense,

> ...there must be no prospect that the acquired firm could continue competing in the market without the particular merger or acquisition under discussion. The failing company doctrine plainly cannot be applied in a merger unless it is established that the company that acquired the failing company is the only purchaser. A unit in the competitive system would be preserved and not lost to monopoly power.[69]

In other words, mergers between competitors (Bic and ASR were both in the razor blade industry) may be allowed if one of the parties involved is failing and merger would be the only way of saving jobs and preserving company relationships.

Although ASR was not seen as a failing company by the FTC when the original complaint was filed, in light of Philip Morris' official announcement that it was liquidating ASR, the doctrine now might be made to apply to ASR. Technically, since ASR was showing a profit, it could not be considered a failed business, but Owen Johnson had indicated the rules could be massaged since he had a certain amount of discretion as anti-trust prosecutor.[70] He did not promise anything definite, however, merely stating that this new possibility was an alternative.[71] The FTC, softening somewhat its original position, offered a compromise. To comply with the doctrine, the FTC asked Philip Morris to place its Razor Division for sale on the open market for sixty days. The FTC would withdraw its complaint, if at the end of that time, Philip Morris did not get an acceptable offer.

Philip Morris rejected the compromise and refused to put ASR on the open market, saying it would agree to the sale only if it occured without any FTC restrictions. It did not attempt to use the failing company defense. The waiting period would have satisfied the FTC and the law, but Philip Morris called the request unreasonable. Philip Morris' reasoning was that it had already spent 20 year's worth of management and legal time from Philip Morris' staff.[72]

Instead, Philip Morris approached the FTC on March 7, requesting a reexamination of its opposition to the sale of ASR to Bic in an effort to break the deadlock over the proposed sale.[73] Philip Morris' request urged the FT to review ASR's possible acquisition by Bic in light of changed circumstances Since Philip Morris was liquidating ASR and ASR would no longer be a competitive factor in the market, Bic's purchase of ASR would not reduce competition. The letter indicated that without ASR's production facilities and technological capabilities, Bic's ability to compete against Gillette would be thwarted. Philip Morris pointed to its layoffs as concrete evidence that ASR was going to leave the razor blade market one way or another.[74]

Philip Morris' March 7 letter did not represent a new proposal, but rather a re-statement of old arguments submitted at the time of the original complaint. It did not attempt the FTC's suggested compromise, nor did it address the points of law in the case.

Responding to the request, the FTC stated that Philip Morris had not provided sufficient information concerning its proposal to sell ASR to Bic for the Commission to evaluate the legality of the transaction. Taking note of Philip Morris' firing of employees and its stated intention to close the ASR plant if the sale to Bic was not permitted, the Commissioners said that the FTC had no control over Philip Morris' independent judgements but regretted the actions that had been taken. The FTC noted that the "hold separate" injunction sought by the FTC against the acquisition would have permitted the further operation of the plant and forestalled the need to lay-off employees. The FTC informed Philip Morris that it needed more information before it could evaluate the new proposal. This included reasons why Philip Morris must liquidate ASR, a profitable business; details of the terms of the new agreement between Philip Morris and Bic concerning the acquisition; specific information concerning offers and contacts Philip Morris had received from potential purchasers of ASR other than Bic; and whether Philip Morris would be willing to seek and evaluate offers for the Razor Division that equalled or exceeded liquidation value.[75] Information that would bolster Philip Morris' claim that Bic was the only seriously interested firm was essential to any argument that the acquisition should be allowed under the "failed company doctrine." That doctrine appeared to be at the core of the FTC's reply to Philip Morris' request for reconsideration.

Stating that new information requested by the FTC would not be provided and that Philip Morris had already answered the Commission's questions, Philip Morris said there would not be a new contract until it received indications from the FTC that its staff would not again intervene in the sale. Philip Morris noted that it had already provided sufficient information concerning potential buyers of ASR other than Bic. However, no specific details other than the names of the prospective purchasers had been provided to the FTC. Philip Morris insisted that the only serious bidder for ASR was Bic, and the FTC insisted on proof. Additionally, there was no indication in the March 7 letter if Philip Morris would be willing to seek and evaluate other offers for ASR, but it had already turned down a similar proposal from the FTC.[76]

The Augusta County's Board of Supervisors, Congressman M. Caldwell Butler, Acting Attorney General Anthony Troy and his assistant Jack Young met at the White House on March 16, 1977 with Jack Watson, Jr., assistant to the President for intergovernmental affairs and secretary of the cabinet, to discuss the ASR situation. Although they attempted to get the Administration to lean on the FTC, Jack Watson took the position that the White House should not get involved. Butler wanted the Department of Justice to take over the ASR acquisition case from the FTC, but Jack Watson deferred to the FTC. To the critics of the FTC action, Jack Watson appeared sympathetic, but overconscious of protocol.[77]

A week later, on March 23, 1977, Bic Pen Corporation ended its plans to acquire ASR, stating it was no longer interested in making the purchase. "We couldn't wait forever" to win approval.[78]

To Bic, Philip Morris, the workers at ASR, and the bevy of Virginia politicians involved in one way or another with the attempt to persuade the FTC to listen to reason, the FTC appeared to them to be the chief antagonist. However, it seems that Philip MOrris was remiss in its chance to meet the concern of the FTC that other companies should be given an opportunity to proffer bids to acquire ASR before Bic could be considered as the only feasible purchaser.

The reason why Bic ended its agreement to purchase ASR from Philip Morris was because ASR was in the process of liquidation and with a considerably reduced inventory and loss in market share, Bic wanted to renegotiate the price and Philip Morris refused. It should be noted that when Philip Morris sold ASR to the management group, the purchase price was adjusted downward to reflect the aforementioned factors.

THE SALE TO MANAGEMENT

When it became clear that the Bic-ASR deal would not go through and that Philip Morris would continue its liquidation plans, the top management of ASR began to think about purchasing the razor blade company. They believed in the blade company's economic future. However, they did not know how to find financing to allow them to buy the company and keep it in operation until ASR's President, John Baker, got a phone call from a San Francisco investment banker. The banker, John Davis, Vice President of Bangert, Dawes, Reade, Davis and Thom, Inc., had read about ASR's imminent closing in Businessweek and thought ASR looked like a candidate for an employee buy-out.[79] Flying to the East Coast, he persuaded a key manager/emplyee group at ASR that it was possible to acquire the razor blade plant in which they had invested their careers.

Philip Morris agreed to sell ASR to ASR's management at a price and terms which approximated the Bic offer ($18.9 million--the net book value at 12/31/76), contingent upon their obtaining financing for the deal. The ASR management group negotiated for the purchase of ASR at a $2.2 million discount from the 12/31/76 book value, to be adjusted to the date of purchase. This appeared to be the lowest possible purchase price since the plant, property, equipment and the sale of the inventory, even in liquidation, were expected to net a value about equal to the stated book value less the $2.2 million discount. Since the purchase price included certain adjustments to ASR's financial conditions (i.e., changes in inventories, profits, etc.) from the net book value at 12/31/76, the purchase price was actually closer to $15 million rather than $16.7 million.[80]

When Philip Morris gave the manager/employee group permission to pursue the deal on company time, the nine men formed a company and called it CIB Industries, Ltd., a paper Delaware corporation used for negotiating purposes by the ASR employee purchasing group. A new name was needed because at that time, the name American Safety Razor belonged to Philip Morris. At the closing of the sale of ASR to CIB, CIB's name was changed to American Safety Razor Company.

The financing to provide funds for the purchase of ASR and for the continued operation of the company under the new owners was arranged on a contingency fee basis by John Davis. (He declined to discuss the amount). Two routes were available to ASR. Either a small management group could buy ASR, using some equity capital with the majority of funding coming from loans, or the entire work force could acquire it through a trust and a federally guaranteed Employee Stock Ownership Plan (ESOP). An ESOP is basically an employee profit-sharing scheme whereby company employees obtain an owners' equity position in their firm in the form of an employee benefit plan. The use of an ESOP is an attractive form of financing mechanism for closely-held or privately owned firms experiencing cash flow problems and/or difficulty in acquiring additional capital. The ESOP's cash flow financial advantage is that the debt repayment is with pretax dollars for both principal and interest payments.

The first option was utilized because the management group was unable to get backing from any financial institutions for an ESOP. Richard Bonin, ASR Vice-president, said that the contacted banks, confident in management's knowledge and experience, wanted guarantees that the same management group would continue to run ASR. The banks felt that one serious problem with the ESOP concept is that once the workers own the company the original management, who the banks are relying on to insure that the firm performs, lose their economic incentives and managerial prerogatives and they leave. This could, according to the banks, jeopardize the company's financial ability to repay the bank's loan.[81]

In a series of meetings starting in March, 1977, John Davis and the ASR managers began to hammer out a strategy. The necessary financing would consist of private and public loans, supplemented by equity funding. They attempted to work out purchase arrangements in cooperation with the EDA, the State Division of Industrial Development, Richard Huff, Augusta County Administrator, Del., A.R. Giesen, R-Staunton and Congressman M. Caldwell Butler. By the end of March, they had talked to every banker in the Verona-Staunton area. The key managers of ASR raised $600,000 of their own personal funds taking out second mortgages, and borrowing on stock to invest as equity in the new company. Initially 60,000 shares were sold. John Baker, President, owns 25%. Richard Bonin, Vice President for Operations, Peter Milone, Director of Marketing, Alan Goldberg, National Sales Manager and Paul Johnson, Western Field Sales Manager, each own 15%. The other four owners, who divide the rest of the shares, are J. Gray Ferguson, Director of Finance, Martin Lightsey, Manager of Engineering, Thomas Greene, Eastern Field Sales Manager, and Robert Ford, Southern Field Sales Manager.[82]

The ASR purchase group got strong backing from the community, since ASR's plant originally provided over 800 jobs. Richmond's Bank of Virginia put together a $9 million credit arrangement with the management group. The $9 million represented 60% of the money needed. The loan agreement consisted of intermediate and long term financing. Proceeds were to be used for the purchase as well as for working capital for ASR. Specifically, ASR obtained a $6,000,000 revolving line of credit from the Bank of Virginia of which approximately $4,718,000 was used to finance the purchase of the assets of ASR. A $3,000,000 term loan to be amortized over a 90 month period was also made by the Bank at an interest rate 3 3/4% above the Bank's prime rate, the same rate as for the $6,000,000 line of credit.[83] "Considering what we were up aginst, we didn't pay so dearly for that money," John Baker concluded. "We feel very lucky to have gotten it."[84] Although CIB scouted major investment firms and banks across the country, then the group settled on local financing since "the EDA really prefers the money coming from the community."[85]

An example of some of the problems confronted by the ASR purchase group concerned plans to issue $4 million worth of long-term mortgage type tax-exempt bonds by the Insudtrial Development Authority of Augusta County in support of the purchase of ASR. The bonds were to be sold to commercial and qualified private investors. They were to have a sinking fund provision over sixteen years commencing in 1980 and ending in 1995, at a nominal coupon rate of between 5½% and 6½%. The bonds were to be secured by certain qualifying land, land improvements, buildings, machinery and equipment at ASR's facility.[86] This financial alternative was terminated in July when CIB became aware of an Internal Revenue Service limit on the size of the company qualifying for tax-exempt bonds. In 1977 the Internal Revenue Service operated under the rule that fixed assets of the company have to remain in the $5 million range for three years from the date of the bond issue. ASR's assets were on the borderline in this respect (at December 31, 1976 the next book value of the fixed assets of ASR were slightly in excess of $6 million),[87] and the ASR management group believed the IRS guideline would limit ASR's growth, so CIB had to seek alternative financing arrangements. In the end, it resorted to the $3,000,000 term loan from the Bank of Virginia already discussed.

The project was supported by both the Commonwealth of Virginia and Augusta County. State financial assistance from the State of Virginia Industrial Revenue

Authority was made permanently available to the Industrial Development Authority of Augusta County, Virginia, in the amount of $250,000 of Economic Development Administration (EDA) "304" funds. The sum of $250,000 was loaned by Augusta County Industrial Development Authority to CIB to supplement the funds needed for the purchase of ASR for a period of twenty-five years, at an interest rate of 3% per annum. These state funds will be used, when repaid by CIB to Augusta County's Industrial Development Authority to set up a revolving fund to be used in the County. A $62,500 state share (25% state matching funds of the $250,000 EDA grant to Virginia) was granted to the Industrial Development Authority of Augusta, County, Virginia to be used by the Authority for administrative expenses to cover past and future expenditures in its effort to save ASR.[88]

In addition, the purchase group sought a $6 million loan from the EDA, the keystone of the financial package. The EDA's assistance was required for CIB to purchase ASR because of the project's limited amount of equity, only 5% of the purchase price, and the need to obtain low interest, long amortization loans. The $6 million EDA loan combined with the aforementioned 304 funds, both for a period of twenty-five years at a 3% interest rate, would save ASR approximately $360,000 in annual interest charges and $300,000 to $400,000 in annual loan amortization, compared with more conventional loan terms for ten years at a 9% interest rate.[89] Therefore, the total annual drain of principal and interest on ASR would be reduced substantially with the EDA's loan terms. However, this comparison is hypothetical since an additional $6 million in bank financing for CIB would probably not be obtainable.

Early in April, EDA officials reviewed the details of the long-term deterioration of Augusta County's economy and employment levels in general and the ASR situation in particular. They met with Richard Huff, County Administrator, J. Brown Hangar, Chairman of the Industrial Development Authority of Augusta

County, John R. Baker and Richard E. Bonin, ASR Plant Manager. Augusta County, home of ASR, had a severely deteriorated employment situation. Unemployment was currently at 8.2% in the County, having risen from 5.7% in late 1976, and would rise even further to almost 11% with the termination of over 800 employees by ASR and other announced layoffs.[90] The County had already suffered negative changes in economic conditions and resource depletion with four plants closing or experienceing reductions in employment in recent years: Lehigh Portland Cement Company had closed; Basic-Wity Furniture Company had closed their Staunton plant; Westinghouse Electric Corporation had decreased its employment level from 1,300 to 400 employees of which 200 persons had been terminated within the last several months; and E.I. DuPont Company had recently begun to terminate approximately 400 employees.[91] The purchase of ASR by CIB would provide for continuation of local employment.

The employees of ASR, threatened with unemployment, had 680 home mortgages at local banks and lending institutions, 470 automobile loans, 935 children of either pre-school age or school age still living at home, and 102 children who were attending college. In addition, 470 ASR employees were categorized by Augusta County as unskilled and probably would encounter great difficulty in gaining employment because of the general adverse employment conditions in the area. More than 270 employees were over age 50, meaning they were not old enough for retirement, but were past the age of desirability for other employers. ASR was located in a semi-rural area that would suffer adverse effects from the removal of an $8.5 million in revenue from the sale of goods and services to ASR from other businesses in the area.[92]

At the end of April, Messrs. Davis, Baker, Bonin and Huff met in Philadelphia at the Atlantic Regional Office of the EDA with Mr. J. Corrigan, Director, Mr. J. O'Neil, Deputy Director and Mr. E. Morris, Chief of the Business Development

Division. The EDA indicated that Augusta County would qualify as a depressed area for federal funds from the EDA, a Commerce Department Agency, and advised Richard Huff to make formal application for an Economic Adjustment Assistance Grant pursuant to Title IX of the Public Works and Economic Development Act of 1965.[93]

Designed to create jobs and revitalize areas suffering economic decline, Title IX attempts to help localities adjust to economic changes resulting in loss of jobs and revenue and to build a solid foundation for long-range economic growth and permanent jobs. In order for an area to be eligible to apply for Title IX assistance, two conditions must be met: a comprehensive economic development plan must be written and the area must be designated as an economic redevelopment area by the Economic Development Administration. This designation means the area is economically depressed based on the unemployment rate and other indicators.

Under Title IX, Federal grants are provided only to not-for-profit groups, and these grants do not have to be repaid to the Federal Government. The Title IX funds may be spent directly by the recipients or they may redistribute the funds to public or private groups through grants, loans or loan guarantees. When the money is repaid, then the grant recipient may recirculate it for additional economic development projects. The concentration and recirculation of funds under Title IX is designed to assure continued economic growth and prosperity in the limited geographical area to which it is given. The enactment in 1975 of Title IX signalled a new approach for the federal economic development programs. It is intended to provide assistance to solve economic problems before they become deep-rooted and before valuable workers are forced to leave the area, and gives broad flexibility to local and state officials to determine the expenditure of funds.

On September 14, 1977 the Augusta County Industrial Development Authority directly applied for the Title IX grant that it planned to loan for the purchase of ASR, but it was denied the funds. This was partially because the County did not develop a sufficient plan for the recycling of the funds which it would receive back from ASR as ASR repaid the loan.[94] Because of the limited funds available nationwide under Title IX and the possibility of future economic dislocations throughout Virginia for which the funds would be needed, the EDA determined that the State was a more appropriate recipient of funds. The EDA could not see how Augusta County could possibly recirculate such a large sum of money in the county. According to Harry Jones, Deputy Director of Virginia's Department of Inter-governmental Affairs, Virginia had only fifteen days in which to submit an application due to the grant deadline imposed by the EDA,[95] but since much of the information needed for application by the State was available in the County's application, Virginia met the deadline.

The EDA awarded a $6 million Title IX grant, the single largest grant made by the EDA under Title IX of its authorization to alleviate unemployment in distressed areas,[96] to the Commonwealth of Virginia on September 28, 1977. The grant proceeds were used to extend a $6 million sub-grant to the Industrial Development Authority of Augusta County, Virginia, which lent those funds to CIB for 25 years at an annual interest rate of 3%. The Augusta County agency will return proceeds from the ASR payments to Virginia for use in a revolving economic development loan fund. The payment schedule between ASR and the County agency outlines semi-annual installments of interest only through February, 1979, in the amount of $90,000 per installment, and semi-annual installments of principal and interest totalling $180,00 each through February 2002.[97] Therefore, approximately $360,000 of funds will be available annually to the State to build up a revolving fund.

The grant gave Virginia flexibility in recirculating the money which the purchasers of ASR must repay on the loan. Under the terms of the grant, upon repayment, the State can use the funds for additional economic development projects throughout the State, especially in Augusta County.[98] The State itself could not loan the money directly to CIB since Section X of the Virginia Constitution prohibits the State from using the credit of the State for private gain.[99] Virginia, however, has a commitment to assist in the maintenance and/or creation of employment for its citizens. In the ASR situation, when the locality could not help to preserve jobs, the State sought the Title IX funds for Augusta County.

The loan to CIB, when combined with financing from other sources, enabled CIB to purchase ASR on September 30, 1977, in the last hour of the last day of the federal fiscal year. Commenting on the sale, ASR's president John Baker said, "The thing almost fell apart once a week." The compilation of the loans took approximately seven months.[100]

Table 1 summerizes the sources and uses involved in the acquisition of ASR by management.

Table 1

Sources of Funds	$ Million
Owners' equity	$0.600
Term loan, Bank of Va.	3.000
EDA Title IX grant	6.000
Revolving line of credit, Bank of Va.	4.718
State of Virginia 304 grant	.250
TOTAL	$14.568
Disposition of Funds	
Purchase price	$14.075
Cash to New Company	.493
TOTAL	$14.568

Source: U.S. Department of Commerce, Economic Development Administration, "Title IX Economic Adjustment Implementation Grant to the Commonwealth of Virginia Department of Intergovernmental Affairs, Division of Special Programs," Project No. 01-19-01653, September 16, 1977.

AMERICAN SAFETY RAZOR AFTER A YEAR: FOLLOW UP AND EVALUATION

ASR, on the verge of total liquidation a year ago, has survived and prospered. Operational independence together with a financial stake in the outcome, have motivated the new owners, all of whom retain about the same responsibilities as they had when they worked for Philip Morris. According to ASR's President, "We think we can operate leaner as a small independent company than we did before. We have management people who have an intimate knowledge of the business, and our production employees are skilled and dedicated."[101]

The marketing strategy for the new company provides a departure from the strategy of ASR under Philip Morris. It recognizes and emphasizes ASR's strengths and de-emphasizes the areas in which ASR is weak with respect to competition. One major change involves the use of a smaller sales organization consisting of only high performance, experienced sales people who concentrate their efforts on those accounts and products which return the majority of sales volume and profit for ASR (approximately 20% of ASR's customers generated 80% of the volume in 1976).[102] The sales force consists of 29 persons, all of which have account responsibility. Administrative procedures have been reduced substantially leaving more time for planning sales presentations and for selling. The reduced sales force is compensated on a salary plus bonus/commission basis rather than the past salary only method. There has also been a restructuring of the sales support group and the sales calendar to reflect the needs of the new sales organization. In summary, ASR's sales force is lean and aggressive and sells primarily to ASR's largest customers, the same ones that it sold to when ASR was owned by Philip Morris.

When ASR become an independent firm, there was a major change in the philosophy of the company. ASR elected to decrease advertising costs by replacing broad range advertising expense with concentrated advertising on a segmented market basis (i.e., advertise the female razor in media reaching primarily females) and by continuing product and trade promotion. This change has helped reduce the advertising expense from about $15 million per year in 1976 to approximately $2 million per year in 1978.[103] ASR's marketing strategy includes effective, timely trade promotions that include consumer incentives and the exploitation of seasonal opportunities when ASR's product use and appeal are greatest (i.e., summer for women's shavers and the winter holiday season).

Additional emphasis has been placed on developing and expanding the firm's production of private label brands. ASR produces razors and blades for such chains as K Mart, People's Drug Stores and Drug Fair Stores. ASR's management believes the company is in a position to dominate the private label market because of its ability to offer and maintain high quality in product and packaging along with effective sales and service support. The company has also increased its production of surgical and industrial blades. ASR's brand, Steri-Sharp, accounted for approximately 40% of surgical blades sales in 1978 and is a $1.5 million to $2.0 million business. In the industrial blade market, ASR represented approximately 65% of the market in 1978 with $10 million worth of sales.[104]

Prior to ASR's sale to its management, the American Safety Razor Division had been operated as a separate reporting unit of Philip Morris. However, Philip Morris provided ASR with executive, administrative, financial, marketing and general management services. With respect to certain of these services, principally the processing and recording of sales, accounts receivables and collections, payroll and related fringe benefits, marketing expenses and general liability insurance, Philip Morris recorded the various transactions and directly allocated the resultant assets, revenues or expenses to ASR. For services performed which were not solely attributable to ASR, Philip Morris charged ASR for the estimated proportionate cost of such services.[105]

The following functional areas were handled in Richmond: data processing, credit, general accounting, payroll, office services, and customer service. The New York City office handled personnel, finance, financial serivces and planning, operations management, and office services. With the reorganization, the sales, marketing, research and executive offices moved to ASR's world headquarters plant in Verona, Virginia. With six of the nine owners working at the plant (there are three regional sales managers), it is easier to react to market conditions.[106]

The restructuring of the company had really been done as a part of the liquidation. Only ten of the salaried employees that were terminated because of the liquidation have returned. However, with production up, ASR has rehired 90% of the hourly employees who were laid off before the purchase. According to management, the people that remain have broader responsibilities than they did before, and are "...busier than they've ever been. It's the only way we can operate at a profit."[107] ASR now employs 640 people, compared to approximately 850 persons at the time when Bic offered to purchase ASR.

ASR manufactures today all the products it was selling a year ago. Philip Morris' plans to eliminate the Personna, Gem and Flicker lines were never consummated because the new management took over before all the back orders were filled. Furthermore, two new products were introduced by ASR: Personna Auto II which began shipping in July, and Flicker Singles which was introduced in May, 1978. Although the company suffered heavy distribution and sales losses when Philip Morris announced it was closing its razor division in 1977, ASR's 1978 sales will approximate ASR's 1976 sales ($42 million versus $42.5 million), since the company has since been able to recapture its distribution level and has built up its surgical, industrial and private label business.[108]

It should be noted that the company's revival affected society. The social costs incurred when a company such as ASR closes include increased unemployment and decreased tax revenues. Had ASR been liquidated, the federal, state and local governments would have lost a valuable source of tax revenue, as indicated below:[109]

Level of Government	Type of Tax	Annual Amount
Federal	Corporate Income	$500,000
	Payroll	240,000
State	Corporate Income	70,000
	Payroll	57,500
Local	Real Estate	12,000
	Personal Property	50,000
Total		$929,500

The employment issue should not be underestimated; ASR pumps approximately $8.5 million in payroll into the local economy and purchases $1.5 million in local goods and services each year. Both the income and employment multiplier effects raise the social benefits to the locality and the state. One implication of this analysis appears to be that supporting this company, and others like it, is in the governments best interest. The fact that the Augusta County, Virginia area derives over $800,000 per year in taxes[110] from the ASR company means that the State of Virginia will have its $6,000,000 loan to CIB (now ASR) benefit its local jurisdictions in the form of tax revenues in only 7.5 years. This means that the social opportunity cost of the EDA loan to Virginia, which in turn loaned it to save ASR, was very low and a worthwhile investment that will be repaid many times over.

CONCLUSION AND RECOMMENDATIONS

The ASR case is another example that adds to the growing literature concerning the impact that conglomerate acquisitions and divestitures can have on depressed areas of the United States. One can say with certainty that Philip Morris did attempt to make ASR a viable competitor against Gillette. However, after 17 years in the razor and blade business, Philip Morris made the economic decision that this part of the nation's consumer market did not meet its investment objectives. As we have already noted, the industry is low growth and expansion of market share is dependent upon increased expenses for advertising and promotion. Philip Morris was just unwilling to expend any more of its funds to increase ASR's market share.

One cannot conclude that Philip Morris' acquisition of ASR in 1960 was inimical to either ASR or Augusta County, Virginia. ASR under Philip Morris' direction turned out to be a highly innovative company. Philip Morris' purchase of ASR must have reflected management's opinion that deemed "...growth, diversification, and the extension of product and geographical markets [to be] important goals..."[111] The decade of the 1960's was the era of conglomerate mergers and acquisitions. The activities almost always resulted in diversification into new types of endeavors and not attempts to gain control of markets they were already in.[112] The 1970's is now the period during which many of these corporate marriages are dissolving for a variety of reasons. Generally speaking, the conglomerates found that the purchases of unrelated enterprises far from home were not highly profitable business decisions afterall. This is found to be particularly true for mature industries like ASR. Other cases worth mentioning are Esmark's National Tanning and Trading Company; Bates Manufacturing Company's Bates Fabrics, Incorporated; Cluett-Peabody's Van Raalte Corporation; L.T.V.'s Okonite Company; and Sperry Rand's Library Bureau.[113]

This devolution of unrelated and/or non-profitable subsidiaries of conglomerates raises an important public policy implication as seen in the ASR case. The issue is that the likely candidates to purchase the mature industries are not other conglomerates but companies that are already in the same market. The existing policy of the FTC as seen in the ASR case, however, would discourage such acquisitions for fear that they may lead to increases in market concentrations. In the ASR case, the competitive prowess of Bic was speculative in nature on the part of the FTC when it determined the sale to be potentially anticompetitive.

In order to avoid the specter of the liquidation of viable manufacturers such as ASR in the future because the failing-company doctrine could not be met, Congress should consider elaborating this doctrine by the enactment of an additional "...statutory pocket of anticompetitive protectionism..."[114] which would be incorporated into Section 7 of the Clayton Act. This elaboration would require the FTC to consider the possible adverse social and economic costs that might accrue to any mergers that it has chosen to investigate. Such a requirement would enable the FTC to assess a merger or acquisition on other than purely antitrust considerations. The FTC would also have to alert other federal agencies such as the EDA and the Farmers Home Loan Administration (FHLA) on the federal level, as well as the home state and the locality (i.e., county or city) of the company, that the FTC is investigating the possible merger. Thus, informed, these agencies could seek alternative aid solutions to save marginal corporations if the FTC disallows the merger plans. This early warning system would give the mature industry and interested governmental agencies some additional time to investigate other avenues that may allow the company to remain open.

ASR was in the process of being liquidated when an alternative option to Bic's purchase of ASR was found. If any further time had elapsed, ASR sales force could have been cut entirely, its market share could have evaporated and its contacts with retailers replaced by existing razor blade manufacturers. If the EDA had been offering alternative job preservation strategies to the State of Virginia, Augusta County, and the employees of ASR all along (that is from the time the FTC first challenged the sale of ASR to Bic), then the partial liquidation might have been averted with the same final positive results occurring--the sale of ASR to its management.

What the FTC has to realize is that a conglomerate such as Philip Morris cannot afford to have its top executives expend enormous amounts of energy on finding another suitable suitor for a subsidiary that accounted for only 1% of total corporate sales and 2/10 of 1% of total profits. It was to Philip Morris' credit that it apparently did search for over two years for a company that would protect ASR's employees. It would appear that Philip Morris is the exception rather than the rule.

The recommended requirement that the FTC alert other federal agencies when looking at mergers will only help to save a small number of companies that face liquidation. There are conglomerates that just liquidate their subsidiaries without giving any governmental bodies any notice. Therefore, one way for the nation to protect mature industries is to enact national legislation that would require that companies planning closings of industrial firms with sales in excess of $1,000,000 and situated in depressed ares as defined by the EDA must give that agency a minimum of three months notice of their intentions. If the EDA, the affected state and local governments, and the employees believe that the company is worth saving (from both a business and social viewpoint), then the EDA approved redevelopment agency for the locality can act quickly since it already has an Overall Economic Development Plan. A similar arrangement could be worked out for the FHLA too.

The United States must begin a concerted effort to retain its viable economic base and competitive edge whenever it exists by assisting mature industries whenever feasible. The Departments of Commerce, Housing and Urban Development, and

Justice, the FTC, the EDA and the FHLA should establish a working and on-going relationship amongst themselves to assist companies in predicaments like the one ASR was in so that these agencies and departments are not working at cross purposes. It makes little sense for the agencies that are charged with the enforcement of anti-trust laws to not also be involved in programs that other agencies have to preserve jobs and industry. The federal government should assist companies like ASR that otherwise might be liquidated due to FTC interference in the corporate acquisition process by looking at alternative routes to preserve the company.

FOOTNOTES

[1] Douglas C. Dobson (FTC Economist), "Affidavit: In the Matter of Bic Pen Corporation, a corporation, and Philip Morris Incorporated, a corporation," Docket No. 9095, December, 1976.

[2] Background material for this discussion was obtained from David Furman, Advertising Director at Bic, Richard Bonin, Vice President for Operations at ASR, and John Davis, Investment Banker. See also Bangert, Dawes, Reade, Davis, and Thom, Inc., "Feasibility Study and Financing Memorandum," unpublished, May 4, 1977, pp. 13-14.

[3] Bro Utall, "Gillette Swings a Mighty Blade Abroad," Fortune, November, 1974, p. 176

[4] Douglas C. Dobson, op. cit.

[5] Douglas C. Dobson, *Ibid*.

[6] Gillette Renews its love for Television Sports," Businessweek, October 23, 1978

[7] The Gillette Company, Annual Report, 1977, p. 4.

[8] Based on interview with David Furman, Advertising Director of Bic Pen Corporation, October 27, 1978.

[9] Douglas C. Dobson, op. cit.

[10] Bic Pen Corporation, 1977 Annual Report.

[11] "President of Bic Pen Shaves the Formality Off Talk in Boston," Wall Street Journal, March 31, 1977.

[12] From interview with David Furman, Advertising Director, Bic Pen, October 27, 1978.

[13] Bic Pen Corporation, 1976 Annual Report.

[14] "President of Bic Pen Shaves the Formality Off Talk in Boston," The Wall Street Journal, March 31, 1977.

[15] Based on interview with David Furman, Advertising Director at Bic Pen Corporation, October 27, 1978.

[16] Douglas C. Dobson, op. cit.

[17] "American Safety Razor Company's Five Year Plan (1976-1981)," unpublished.

[18] Based on interview with Richard Bonin, Vice President for Operations at American Safety Razor Company, October 20, 1978. See also, "Nick of Time," Fortune, September, 1977.

HISTORY

[19] "French Firm's Bic Pen Reaches Accord to Buy Philip Morris Division," Wall Street Journal, December 31, 1976.

[20] Jerry Knight, "American Safety Razor Cuts Corporate Strings," The Washington Post, October 23, 1977.

[21] Based on interview with Robert Ryan, Manager, Corporate Relations, Philip Morris, October 6, 1978.

SALE

[22] Clifford H. Goldsmith, President of Philip Morris, U.S.A., "Affadavit," unpublished, February 2, 1977.

[23] Figures provided by Robert Ryan, Manager, Corporate Relations, Philip Morris, October 6, 1978.

[24] Goldsmith, op. cit.

[25] Goldsmith, Ibid.

[26] Clifford Goldsmith, "Letter to ASR Employees," unpublished, December 30, 1976.

[27] "Gillette After the Diversification that Failed," Businessweek, February 28, 1977.

[28] "Agreement for the Acquisition of the American Safety Razor Division of Philip Morris, Inc.," Unpublished, December 30, 1976.

[29] "Bic to Run American Safety Razor Autonomously," Advertising Age, January 31, 1977.

THE FTC CHALLENGE

[30] Based on interview with Ronald Dolan, Assistant Director of the FTC's Bureau of Competition, October 13, 1978.

[31] Federal Trade Commission, "Complaint: In the Matter of Bic Pen Corporation, a corporation and Philip Morris, Inc., a corporation," Docket No. 9095, February 9, 1977.

[32] Merrill Brown, "Bic's Marketing Success Called Factor in FTC Decision," Richmond-Times Dispatch, February 9, 1977.

[33] Federal Trade Commission, op. cit.

[34] Bill Brown, "ASR Plant Manager Optimistic," The Staunton Leader, March 3, 1977.

[35] From discussion with Robert Ryan, Manager of Corporate Relations at Philip Morris, David Furman, Advertising Director of Bic and Congressman M. Caldwell Butler. See also, "FTC: What Goals," The News-Virginian, February 24, 1977 and James J. Kilpatrick "Commentary on Razors," taped on March 3, 1977.

[36] Lee Hotz, "Philip Morris to Break Silence on Status of ASR in a Few Days," The News-Virginian, February 24, 1977.

[37] Lee Hotz,"FTC Defends Challenge to Sale of Razor Firms," The News-Virginian, February 23, 1977.

[38] Federal Trade Commission, op. cit.

[39] "Negotiations Fall Through," The Staunton Leader, February 18, 1977.

[40] Goldsmith, op. cit.

[41] From interview with Congressman M. Caldwell Butler, October 27, 1978.

[42] Lee Hotz, "Giant ASR Delegation Signs for D.C. Protest," The News-Virginian, March 1, 1977.

[43] From interview with Robert Ryan, Manager of Corporate Relations at Philip Morris, October 6, 1978.

[44] Federal Trade Commission, "Memorandum of Points and Authorities in Support of Application for Temporary Restraining Order and Preliminary Injunction," Civil Action No: 77-0616, February, 1977.

[45] *Ibid.*

[46] "FTC Interference Kills Bic's Plans to Acquire ASR," United States Tobacco Journal, Vol. 205-No. 15, April 14, 1977.

[47] From interview with David Furman, Advertising Director, Bic Pen Corporation, October 27, 1978.

[48] "Why Bic Dropped its U.S. Razor Deal," Businessweek, March 7, 1977.

[49] Philip Morris publicity release dated February 17, 1977.

[50] U.S. District Court for the Souther District of New York, "Consent Order of Dismissal," Civil Action No. 77 Civ. 646 (LWP), February 25, 1977.

THE REACTION

[51] Thomas Goldwasser, "When Executives Buy Their Companies," The New York Times, March 5, 1978.

[52] "Initial ASR Layoff to Affect 181 Persons Starting Next Week," The News-Virginian, February 26, 1977.

[53] "ASR Employees Take Case to D.C.," The Staunton Leader, March 2, 1977.

[54] "ASR to Lay-Off 400 Workers," The Staunton Leader, February 25, 1977.

[55] From interview with Ronald Dolan, Assistant Director of the FTC's Bureau of Competition, October 13, 1978.

[56] Lee Hotz, "ASR Employment is Cut 50 Percent," The New-Virginian, February 25, 1977.

[57] "County Protests Ban of ASR Sale," The Staunton Leader, February 23, 1977.

[58] Steve Haner, "Employees Hanging by Noose," Roanoke Times & World News, February 27, 1977.

[59] "Wheels Turn to Get FTC Ruling Changed," The Staunton Leader, February 23, 1977.

[60] "Butler Evaluating Delicate ASR-Bic Pen Situation," The Staunton Leader, February 24, 1977.

[61] "Cleaning Up Antitrust," United States Tobacco Journal, Vol. 205-No. 15, April 14, 1977.

[62] Gary Robertson, "Razor Firm Sale Termed Possible, The Richmond Times Dispatch, March 3, 1978.

[63] George Lazarus, "Workers Losing Jobs to Picket FTC," Chicago Tribune, March 2, 1977.

[64] Athelia Knight and Thomas Grubisich, "Verona, Va. Fights to Save 800 Jobs," Washington Post, March 3, 1977.

[65] "Verona: 500 from Shenandoah Valley Come Here In Battle to Save Economy of Their County," Washington Post, March 3, 1977.

[66] John Holusha, "Razor Workers Protest at FTC," The Washington Star, March 3, 1977.

[67] "FTC Suggests Method for Sale," The News-Virginian, March 3, 1977.

[68] "FTC Bows to Pickets, State Solons," (sic) The News-Virginian, March 3, 1977.

[69] This is the Federal Court Ruling that explains the failing company doctrine.

[70] "FTC Picketed; ASR Workers Optimistic," The Roanoke Times, March 3, 1977.

[71] Steve Hanes, "ASR Workers Optimistic After Washington March," The Roanoke Times, March 3, 1977.

[72] "Compromise on ASR Sale is Rejected," The News-Virginian, March 3, 1977.

[73] Philip Morris, Inc. Asks FTC to Review Stance on Sale of Unit to Bic," The Wall Street Journal, March 11, 1977.

[74] Lee Hotz, "Philip Morris--FTC Meeting Asked," The News-Virginian, March 8, 1977

[75] Lee Hotz, "FTC Wants More Information on Latest Philip Morris Plan," The News Virginian, March 11, 1977.

[76] Lee Hotz, "Philip Morris is Reported Unwilling to give New Data," The News-Virginian, March 18, 1977.

[77] Based on interview with Congressman M. Caldwell Butler, October 27, 1978.

[78] "ASR: A Lesson," The News-Virginian, March 25, 1977.

THE SALE TO MANAGEMENT

[79] From interview with John Davis, Vice President of Bangert, Dawes, Reade, Davis and Thom, Inc., October 10, 1978.

[80] Bangert, Dawes, Reade, Davis & Thom, Inc., "Feasibility Study and Financing Memorandum-Purchase of ASR from Philip Morris, 1977," unpublished, May 4, 1977

[81] Based on interview with Richard Bonin, Vice President for Operations at American Safety Razor Company, December 10, 1978.

[82] Ibid., October 20, 1978.

[83] From an interview with Harry Jones, Deputy Director of Virginia's Department of Intergovernmental Affairs, October 18, 1978.

[84] Goldwasser, op. cit.

[85] From an interview with Richard Bonin, Vice President for Operations at ASR, December 10, 1978.

[86] Bangert, Dawes, Reade, Davis & Thom, Inc., op. cit.

[87] Ibid.

[88] Based on interview with Harry Jones, Deputy Director of Virginia's Department of Intergovernmental Affairs, October 18, 1978.

[89] Based on interview with Mr. Moore, Economic Development Administration Atlantic Regional Office, October 24, 1978. See also "Title IX Economic Adjustment Implementation Grant to the Commonwealth of Virginia," Project No. 01-19-01653, September 16, 1977.

[90] Commonwealth of Virginia, Department of Intergovernmental Affairs, Division of Special Programs, "Commonwealth of Virginia Economic Development Assistance Program," Part IV--Program narrative, State No. 8-193-004, Federal No. 11.307, September 13, 1977.

[91] U.S. Department of Commerce, Economic Development Administration, "Title IX Economic Adjustment Implementation Grant to the Commonwealth of Virginia, Department of Intergovernmental Affairs, Division of Special Programs," Project No. 01-19-01653, September 16, 1977.

[92] Commonwealth of Virginia, Department of Intergovernmental Affairs, Division of Special Programs, op. cit.

[93] The discussion on Title IX of the Public Works and Economic Development Act of 1965 is based on interviews with Congressman Caldwell Butler, Mr. Moore of the Atlantic Regional Office of the EDA and Frank Tsutras (interview on October 16, 1977), Director of the Congressional Rural Caucus.

[94] Based on interview with Richard Huff, Augusta County Administrator, October 18, 1978.

[95] Based on interview with Harry Jones, Deputy Director of Virginia's Department of Intergovernmental Affairs, November 18, 1978.

[96] Bill Brown, "Sale of ASR Expected to be Completed This Afternoon," The Staunton-Leader, September 30, 1977.

[97] "Agreement of Sale Between Industrial Development Authority of Augusta County, Virginia and CIB Industries Limited," Unpublished, September 30, 1977, Schedule C, Promissory Note of CIB Industries Limited. n.p.

[98] U.S. Department of Commerce, Economic Development Administration, "Economic Adjustment Assistance Grant Agreement," September 28, 1977.

[99] Based on an interview with Harry Jones, Deputy Director of Virginia's Department of Intergovernmental Affairs, October 18, 1978.

[100] Estes Thompson, "Once Imperiled Firm is Alive and Well," The Washington Star, May 20, 1978.

A.S.R. AFTER A YEAR: FOLLOW UP AND EVALUATION

[101] Gary Robertson, "Razor Plant Role Played by San Francisco Banker," The Richmond-Times Dispatch, October 9, 1977.

[102] Based on an interview with Richard Bonin, Vice President for Operations, ASR, October 27, 1978.

[103] Based on an interview with Richard Bonin, Vice President for Operations, ASR, October 27, 1978.

[104] Ibid.

[105] Based on an interview with Richard Bonin, Vice President for Operations, ASR, October 20, 1978.

[106] Ibid.

[107] Ibid.

[108] Ibid.

[109] Based on an interview with Richard Bonin, Vice President for Operations, ASR, December 10, 1978.

[110] "Agreement of Sale Between Industrial Development Authority of Augusta County, Virginia and CIB Industries Limited," Unpublished, September 30, 1977, Schedule C, Promissory Note of CIB Industries Limited. n.p.

[111] Jesse W. Markham, Conglomerate Enterprise and Public Policy (Boston: Harvard University Graduate School of Business Administration, 1976), p. 22.

[112] *Ibid.*, p. 19.

[113] William Foote Whyte, "In Support of the Voluntary Employee Ownership and Community Stabilization Act," Draft Statement, March 20, 1978, passim.

[114] Richard A. Posner, *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976), p. 20.

INTERVIEWS

1. Robert Ryan, Manager of Corporate Relations, Philip Morris, Inc. 10/06/78. Topics discussed: ASR's history, reasons for plant divestiture by Philip Morris, BIC's proposed purchase of ASR, the FTC's interference with the sale to BIC.

2. John Davis, Vice President, Bangert, Dawes, Reade, Davis, & Thom, Inc., 10/10/78. Topics discussed: Financing arrangements, John Davis' involvement in purchase of ASR

3. Ronald Bolen, Assistant Director, FTC's Bureau of Competition 10/13/78. Topics discussed: FTC's challenge to the BIC's acquisition of ASR nature of razor blade industry.

4. Frank Toutree, Director of the Congressional Rural Caucus 10/16/77. Topics discussed: Political pressure applied to the FTC, review of OEDP.

5. Marlene Hoover, Aide to Congressman M. Caldwell Butler 10/16/78. Topics discussed: Congressman Butler's involvement with the FTC.

6. Elizabeth Lenhardt, Administrator Assistant to the New York Regional Manager, A.C. Nielsen Company 11/16/78. Topics discussed: Market trends in the razor blace industry, structure of industry.

7. Harry Jones, Deputy Director of Virginia's Department of Intergovernmental Affairs 10/18/78. Topics discussed: Social implications of the liquidation of ASR, taxes paid by ASR.

8. Richard Huff, County Administrator, Augusta County, Virginia 10/18/78. Topics discussed: Effect of liquidation of ASR on Augusta County, County's application for EDA funds.

9. Richard Bonin, Vice President for Operations, American Safety Razor Company 10/20/78. Topics discussed: BIC's contemplated purchase of ASR, the FTC's challenge to the purcrase, effect of ASR, BIC's withdrawal from the purchase and financing arrangements.

10. John Davis, Vice President, Bangert, Dawes, Reade, Davis & Thom, Inc. 10/24/78. Topics discussed: Purchase of ASR by ASR's management team.

11. Mr. Moore, Economist, EDA Atlantic Regional Office 10/24/78. Topics discussed: General information regarding Title IX grants, designations of EDA Qualified Areas, OEDP review, rejection of County's application for aid, and success of state's application for funding.

12. David Furman, Advertising Director, BIC Pen Corporation 10/27/78. Topics discussed: FTC's role in blocking BIC's acquisition of ASR, general nature of razor blade industry, recent market trends, structure of the industry, BIC's entrance into razor blade market.

13. Douglas C. Dobson, Federal Trade Commission Economist 10/27/78. Topics discussed: General nature of razor blade industry, structure of the industry, FTC's role in the BIC-ASR case.

14. M. Caldwell Butler, Congressman, Sixth District, Virginia 10/27/78. Topics discussed: Political pressure applied to FTC and EDA.

15. Richard Bonin, Vice President for Operations, American Safety Razor Company 10/27/78. Topics discussed: EDA Title IX grant, ASR's organization today versus under Philip Morris, ASR's 1977 and 1978 business.

16. M. Caldwell Butler, Congressman, Sixth District, Virginia 10/30/78. Topics discussed: FTC's rationale for challenging the merger; adverse impact on County of liquidation of ASR.

17. Richard Bonin, Vice President for Operations, American Safety Razor Company 11/15/78. Topics discussed: details of purchase of ASR from Philip Morris, general nature of razor blade industry.

18. Richard Bonin, Vice President for Operations, American Safety Razor Company 12/10/78. Topics discussed: Social implications of the liquidation of ASR, taxes paid by ASR.

BIBLIOGRAPHY

"Agreement of Sale Between Industrial Development Authority of Augusta County, Virginia and CIB Industries Limited," unpublished, September 30, 1977, Schedule C, Promissory Note of CIB Industries Limited.

American Safety Razor Company's Five Year Plan (1976-1981). Unpublished, 1975.

"ASR Employees Take Case to D.C.," The Staunton Leader, March 2, 1977

"ASR to Lay-Off 400 Workers," The Staunton Leader, February 25, 1977

"ASR: A Lesson," The News-Virginian, March 25, 1977

Bangert, Dawes, Reade, Davis & Thom, Inc., "Feasibility Study and Financing Memorandum-Purchase of ASR from Philip Morris, 1977," unpublished, May 4, 1977.

"Bic to Run American Safety Razor Autonomously," Advertising Age, January 31, 1977

Bic Pen Corporation, 1977 Annual Report

Bic Pen Corporation, 1976 Annual Report

Bic Pen Corporation and Philip Morris, Inc. "Agreement for the Acquisition of the American Safety Razor Division of Philip Morris, Inc." Unpublished, December 30, 1976

Brown, Merrill. "Bic's Marketing Success Called Factor in FTC Decision," Richmond-Times Dispatch, February 24, 1977

Brown, Bill. "ASR Plant Manager Optimistic," The Staunton Leader, March 3, 1977

Brown, Bill. "Sale of ASR Expected to be Completed This Afternoon," The Staunton Leader, September 30, 1977

"Butler Evaluating Delicate ASR-Bic Pen Situation," The Staunton Leader, February 24, 1977

"Cleaning Up Antitrust," United States Tobacco Journal, Vol. 205-No. 15, April 14, 1977

Commonwealth of Virginia, Department of Intergovernmental Affairs, Division of Special Programs, "Commonwealth of Virginia Economic Development Assistance Program," State No. 8-193-004, Federal No. 11.307, September 16, 1977.

"Compromise on ASR Sale is Rejected," The News-Virginian, March 3, 1977

"County Protests Ban of ASR Sale," The Staunton Leader, February 23, 1977

Federal Trade Commission, "Affidavit: In the Matter of Bic Pen Corporation, a corporation, and Philip Morris Incorporated, a corporation," Docket No. 9095, December 1976

Federal Trade Commission, "Complaint: In the Matter of Bic Pen Corporation, a corporation and Philip Morris, Incorporated, a corporation," Docket No. 9095, February 9, 1977.

Federal Trade Commission, "Memorandum of Points and Authorities in Support of Application for Temporary Restraining Order and Preliminary Injunction," Civil Action No. 77-0616, February, 1977.

"French Firm's Bic Pen Reaches Accord to Buy Philip Morris Division," Wall Street Journal, December 31, 1976.

"FTC Bows to Pickets, State Solons," (sic) The News-Virginian, March 3, 1977.

"FTC Interference Kills Bic's Plans to Acquire ASR," United States Tobacco Journal. Vol. 205-No. 15, April 14, 1977.

"FTC Suggests Method for ASR Sale," The News-Virginian, March 3, 1977.

"FTC Picketed; ASR Workers Optimistic," The Roanoke Times, March 3, 1977

"FTC: What Goals," The News-Virginian, February 24, 1977.

"Gillette After the Diversification That Failed," Businessweek, February 28, 1977.

"Gillette Renews its Love for Television Sports," Businessweek, October 23, 1978.

Goldsmith, Glifford. "Affidavit". Unpublished, February 2, 1977.

Goldsmith, Clifford. "Letters to ASR Employees". Unpublished, December 30, 1976

Goldwasser, Thomas. "When Executives Buy Their Companies," The New York Times, March 5, 1978

Haner, Steve. "ASR Workers Optimistic After Washington March," The Roanoke Times, March 3, 1977

Haner, Steve. "Employees Hanging by Noose," Roanoke Times & World News, February 27, 1977.

"1976 Health and Beauty Aids Study," Chain Store Age, October, 1976

Holusha, John. "Razor Workers Protest at FTC," The Washington Star, March 3, 1977

Hotz, Lee. "ASR Employment is Cut 50 Percent," The News-Virginian, February 25, 1977

Hotz, Lee. "FTC Defends Challenge to Sale of Razor Firms," The News-Virginian, February 23, 1977.

Hotz, Lee. "FTC Wants More Information on Latest Philip Morris Plan," The News-Virginian, March 11, 1977.

Hotz, Lee. "Giant ASR Delegation Signs for D.C. Protest," The News-Virginian, March 1, 1977.

Hotz, Lee. "Philip Morris - FTC Meeting Asked," The News-Virginian, March 8, 1977

Hotz, Lee. "Philip Morris is Reported Unwilling to Give New Data," The News-Virginian, March 18, 1977.

Hotz, Lee. ""Philip Morris to Break Silence on Status of ASR in a Few Days," The News-Virginian, February 24, 1977.

"Initial ASR Layoff to Affect 181 Persons Starting Next Week," The News-Virginian, February 26, 1977.

Kilpatrick, James J. "Commentary on Razors." Unpublished. March 3, 1977.

Knight, Athelia and Grubisich, Thomas. "Verona, Va. Fights to Save 800 Jobs," Washington Post, March 3, 1977.

Knight, Jerry. "American Safety Razor Cuts Corporate Strings," The Washington Post, October 23, 1977.

Lazarus, George. "Workers Losing Jobs to Picket FTC," Chicago Tribune, March 2, 1977.

Markham, Jesse. Conglomerate Enterprise and Public Policy. Boston: Harvard University Graduate School of Business Administration, 1976.

"Negotiations Fall Through," The Staunton Leader, February 18, 1977.

"Nick of Time," Fortune, September, 1977.

Nielsen, A.C. 42nd Annual Nielsen Review of Retail Drug Store Trends. published in cooperation with Chain Store Age, May 1978.

"Philip Morris, Inc. Asks FTC to Review Stance on Sale of Unit to Bic," The Wall Street Journal, March 11, 1977.

Posner, Richard. Antitrust Law: An Economic Perspective. Chicago: University of Chicago Press, 1976.

"President of Bic Pen Shaves the Formality off Talk in Boston," The Wall Street Journal, March 31, 1977.

Robertson, Gary. "Razor Firm Sale Termed Possible," The Richmond Times Dispatch, March 3, 1978.

"Schick Sets Launch of New Ladies' Shaver," Advertising Age, February 28, 1977.

Thompson, Estes. "Once Imperiled Firm is Alive and Well," The Washington Star, May 20, 1978.

U.S. Department of Commerce, Economic Development Administration, "Economic Adjustment Assistance Grant Agreement," September 28, 1977.

U.S. Department of Commerce, Economic Development Administration, EDA Qualifed Areas Map, Jan. 1977.

U.S. Department of Commerce, Economic Developmen Administration, Guide for Area Overall Economic Development Program, Washington, D.C., February 1976.

U.S. Department of Commerce, Economic Development Administration, "Title IX Economic Adjustment Implementation Grant to the Commonwealth of Virginia, Department of Intergovernmental Affairs, Division of Special Programs," Project No. 01-19-01653, September 16, 1977.

U.S. District Court for the Southern District of New York. "Consent Order of Dismissal," Civil Action No. 77 Civ. 646 (LWP), February 25, 1977.

Utall, Bro. "Gillette Swings a Mighty Blade Abroad," Fortune, November, 1974.

"Verona: 500 from Shenandoah Valley Come Here In Battle to Save Economy of Their County," The Washington Post, March 3, 1977.

"Wheels Turn to Get FTC Ruling Changed," The Staunton Leader, February 23, 1977.

"Why Bic Dropped its U.S. Razor Deal," Businessweek, March 7, 1977.

Whyte, William Foote. "In Support of the Voluntary Employee Ownership and Community Stabilization Act," Draft Statement, March 20, 1978.

Appendix G.—Sworn Affidavit of Clifford Goldsmith, Philip Morris; re Philip Morris' Intention to Liquidate American Safety Razor Co.

AFFIDAVIT

STATE OF NEW YORK)
: SS.:
COUNTY OF NEW YORK)

CLIFFORD H. GOLDSMITH, being duly sworn, deposes and says that:

1. I am a director and an Executive Vice President of Philip Morris Incorporated (the "Company"). I am also the President of Philip Morris U.S.A., one of the five operating companies of the Company and, as such, I am responsible for domestic tobacco operations and the operations of the American Safety Razor Division (the "Razor Division") of the Company.

2. The Company has made a firm decision to withdraw from the razor blade business.

3. On December 15, 1976, the Company's Board of Directors authorized me to sell the assets and good will of the Razor Division to Bic Pen Corporation ("Bic") for the book value thereof upon such terms and conditions as I, as President of Philip Morris U.S.A., should approve. At the time of such

authorization, counsel for the Company and counsel for Bic were actually negotiating a contract for the sale of the Razor Division to a subsidiary of Bic. The definitive contract was signed on December 30, 1976. I have been advised by counsel that a copy of this contract has been furnished to the staff of the Federal Trade Commission (the "Commission").

.4. At a Board of Directors meeting of the Company held on January 26, 1977, I advised the members of the Board, who were already aware of the execution of the contract with Bic, that the staff of the Commission had begun an investigation to determine what action, if any, the Commission should take with respect to the acquisition of the Razor Division by Bic and that the staff had requested a delay until February 28, 1977 in the closing of the sale which had been scheduled for January 31, 1977. I further advised the Board that if the Commission prevented the consummation of the sale it would be my decision to liquidate the Razor Division.

5. The top management of the Company had been dissatisfied with the performance of the Razor Division for many years and had urged that Philip Morris U.S.A. withdraw from the razor blade business. I felt most strongly that as long as the Razor Divison did not materially detract from the Company's overall performance, we should make every effort to protect the jobs and benefits of the employees of the Razor

Division not because of any legal obligation, but out of concern for the people involved. Accordingly, in connection with all discussions that were held with prospective purchasers, I took the position that we would not sell the Razor Division unless two conditions were met: The employees were protected and the Company received book value for the Razor Division. None of the parties with whom we had discussions, other than Bic, were able to give me assurances in this regard. The contract between the Company and Bic contains extremely detailed provisions with respect to the employee benefits which will be maintained by the Bic subsidiary which will succeed to the business of the Razor Division. Counsel have advised me that this point was one of the most difficult ones in the negotiations and required protracted discussions.

6. In December of 1976, the 870 employees of the Razor Division were notified of the proposed sale to Bic and that their employee benefits would be protected. This announcement was the first notice to the employees that the Company was contemplating the sale of the Razor Division, although there had been many rumors in this regard through the years. Because of the obvious problems involved in retaining employees and maintaining morale in a business which is up for sale, I had been insistent that strict security be maintained with respect to any discussions with potential purchasers of the Razor Division. Accordingly, I reported to

the Board that since the employees had been advised of this sale, I would not continue operations if the sale to Bic were not consummated and that in such event I would proceed with the liquidation of the Razor Division.

7. The Razor Division was acquired in May of 1960. In the calendar year 1976, the Razor Division had operating revenues of approximately $42,000,000, and operating income, i.e., profit before taxes and interest, of approximately $1,500,000. The Company's investment in the Razor Division amounts to approximately $20,000,000, and the return on this investment is less than the carrying cost of the assets.

8. The senior management of the Company had decided quite some time ago that with the Company's growth in other areas its participation in the razor blade business could not possibly be material to the Company's profitability. The Company's experience in the business has been unsuccessful after 17 years of effort. The industry, which only produces retail sales of approximately $300,000,000 annually ($200,000,000 at the manufacturer's level), is dominated by the Gillette Company. Any attempt to increase the Razor Division's market share would require a huge investment on which the Company would not realize an adequate return. Consolidated operating revenues and consolidated operating income of the Company in 1976 were $4,293,782,000 and $634,539,000, respectively. Consolidated assets of the Company at December 31, 1976 were $3,582,209,000. Thus it is obvious

that the Company's time and efforts are much more profitably spent in its other lines of business and that it should realize what it can on its investment in the Razor Division and concentrate its efforts on its primary source of revenues and income.

9. The Company has had discussions with several prospective purchasers. For example, in 1976 discussions were had with American Home Products Corporation, Carter-Wallace, Incorporated, The Coca Cola Bottling Company of New York, Inc., and Shulton, Inc.; in 1975 with Kaman Corporation, Regulus International Capital Corporation, Sterling Drug, Inc., The Wonder Corporation, and with a group of individual investors; and in 1974 with British Match Corporation. In each instance my insistence on protecting the employees and realizing book value proved to be insuperable obstacles.

10. With the conclusion of the agreement with Bic, I had realized my objective of protecting the employees. If the Commission prevents the consummation of the sale I must now proceed with the liquidation of the Razor Division. I believe that the Company can realize almost as much from a liquidation of the Razor Division as it can from the sale to Bic. Under the agreement with Bic, the Company would receive approximately $4,100,000 in cash and a $15,000,000 promissory note payable over 12 years, bearing interest at the rate of

6 1/4% per annum. Our investment bankers have advised us that this note would have a present value of approximately $13,000,000. I am advised that the Company can probably realize on liquidation of the Razor Division approximately $5,000,000 in cash this year and an additional $10,000,000 within two years. I therefore consider it now to be in the best interests of the stockholders of the Company to liquidate the Razor Division if the sale to Bic cannot be concluded.

11. I am fully aware that a decision to liquidate the Razor Division will have the adverse effect on the employees that I have strived so long to prevent. However, as indicated above, I believe that the Company has met its obligations. If the sale to Bic is not consummated I will proceed with a plan of liquidation which will entail the winding down of the operations of the Razor Division. While the Razor Division might be required to continue the production of industrial and surgical blades, it would immediately cease all consumer advertising and drastically reduce its sales force. Should its raw steel inventory require or permit, the Razor Division might continue to manufacture private brand razor blades, but in any event it will cease to be a competitive force in the brand name razor blade market, the market which is dominated by the Gillette Company.

12. It is our present estimate that within 30 days, approximately 200, and by year-end approximately 570, of the 870 employees of the Razor Division will be dismissed if the sale to Bic is not consummated.

Clifford H. Goldsmith

Sworn to before me this

2nd day of February, 1977

Notary

I. DAVID FINK
Notary Public, State of New York
No. 4576132
Qualified in New York County
Commission Expires March 30, 1978

APPENDIX H.—STAFF SUMMARY OF DEPARTMENT OF JUSTICE MEMO, RE YOUNGSTOWN SHEET AND TUBE-LYKES CORP. MERGER

BERKLEY BEDELL, IOWA
CHAIRMAN
[illegible]

United States House of Representatives
Committee on Small Business
Subcommittee on
Antitrust and Restraint of Trade
Activities Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

[illegible]

February 4, 1980

To: Hon. Berkley Bedell, Chairman

From: Mark J. Levine, Staff Assistant

Re: Department of Justice Memo on the
Lykes/Youngstown Sheet and Tube Merger

Mr. Chairman, during the Antitrust Subcommittee's February 1 hearing on conglomerate mergers and their effects on small business and local communities one of the witnesses, Ed Kelly, made reference to a Department of Justice memo evaluating the proposed merger of the Lykes Corp., a shipping concern, and Youngstown Sheet and Tube, an integrated steel manufacturer and one of the largest employers in the Youngstown, Ohio area.

The memo was written by an Assistant Trial Chief, George R. Schueller, and it exposed the economic frailty of the proposed merger. The memo pointed out that the modernization plans contemplated by the management of Youngstown Sheet and Tube would probably be abandoned by the management of Lykes. Mr. Schueller noted -the lack of commitment to steel manufacturing on the part of the management of Lykes. The memo asserts that the competitive viability of Youngstown Sheet and Tube would be threatened. The Department of Justice, however, did not challenge the merger.

The uncanny accuracy of Mr. Schueller's memo was noted during the course of the Subcommittee's discussions of Youngstown Sheet and Tube's history. I have summarized Mr. Schueller's memo for the use of the Subcommittee.

Attachment

Friday, February 1
Case No. 5

Youngstown Sheet and Tube, Youngstown, Ohio

The following is a summary of an internal Department of Justice memo prepared by George H. Schueller, an Assistant Trial Chief, dated April 30, 1969.

Youngstown Sheet and Tube was an integrated iron and steel producer. In 1969 it was the eighth largest in the nation, with 4.5% of the nation's steel production. It employed 26,000 workers, and had assets of $1.03 billion.

Lykes Corporation was a holding company in 1969, primarily in the steamship business. They were ranked 44th on the Fortune 500 list of transportation companies. Lykes assets were $376 million in 1969.

In 1968, Lykes Brothers Steamship Company reorganized as a holding company, Lykes Corp., to free a portion of its statutory reserves required under the Maritime Act of 1916. These funds now became available for investments in non-maritime businesses.

Both the steamship and steel industries are extremely cyclical and return relatively low profit margins. The management of Lykes Corp. appeared to be interested in acquiring Youngstown Sheet and Tube (YST) because of its huge cash flow, retained earnings and depreciation charges, that are characteristic of the steel industry. YST had an average cash flow of of $92.52 million in the five years preceding the merger, and average capital expenditures of $95 million during those years. These capital expenditures were necessary for YST to keep its present position in the industry. Larger expenditures were needed to improve its profitability, which was low by industry standards.

As an independent company, the management of YST prepared two separate capital expenditure plans that earmarked investments needed to improve YST's industry position, (basic oxygen furnaces, an expansion of coke facilities, plant additions, new furnaces, and new production facilities). These investments were vital for YST because of increasing competition from modern steel facilities in Japan and Europe.

In 1968, Lykes Corporation and its banker Kuhn, Loeb, convinced YST management to merge, (a first offer was rejected). Lykes Corp., only one third the size of YST, would be the surviving company, organized as a Delaware corporation.

The competitive viability of YST was jeopardized by the merger with Lykes. Its long term debt/assets ratio rose from 18.3% to 32.27%. The President of Lykes, F.A. Nemac, was quoted in Forbes on April 9, 1969 as saying, "I will not hesitate to make use of Youngstown's $100 million annual cash flow to move into other fields if our views on the future of steel should change." With the steel industry's average profitabilty at 7½ percent, there was serious question if YST's vital capital investment plan would be followed.

Lykes had to borrow $56 million in long term debt to effectuate the merger. YST's equity to long term debt ratio rose from 34.84% before the merger, to 74.61% after the merger. This is unhealthy in the steel industry because low profits in lean years make funds scarce for interest payments.

The Department of Justice memo stated "As a result of the merger, the funds available for modernizing Youngstown Sheet and Tube will decrease; and the new top management, without tradition in steelmaking and not committed to the old management's capital expenditure plan, is much less likely to modernize Youngstown Sheet and Tube to the extent necessary to keep it competitive."

Note from the Subcommittee Staff

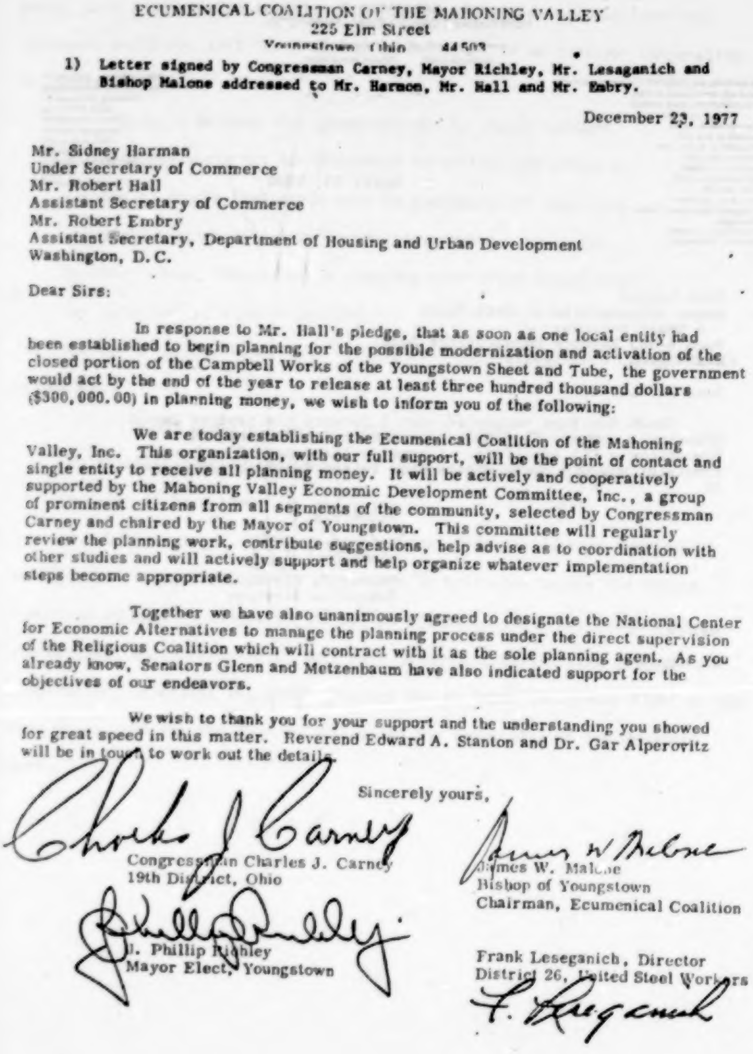
Youngstown Sheet and Tube was forced to close its Campbell Works facility in September 1977, laying off 4200 workers and severely affecting the economy of Youngstown, Ohio. It appears that YST's cash flow was used by Lykes to pay its interest payments on loans taken to finance the merger, and to subsidize its shipping operations. Between 1972 and 1976, the steamship operation was subsidized to the amount of $216 million by Lykes' other operations. Huge depreciation allowances were also taken by Lykes at YST to bolster their consolidated earnings.

To remedy their desparate situation, Lykes merged with LTV. LTV was another conglomerate with an unprofitable steel subsidiary, Jones and Laughlin. J&L and YST when combined, formed the third largest steel producer in the industry. The Justice Department had ruled in 1970, that LTV, as a result of its acquisition of J&L , was to restrain from acquiring interest in another concern of more than $100 million. Lykes assets were in excess of $1.76 billion.

The DOJ approved the merger in May 1978, citing the failing company doctrine. The same day this was announced, Lykes and YST reported a $7.6 million profit for the second quarter. Shortly after the merger another plant in the Youngstown Sheet and Tube family was shut down, the Briar Hill plant, as the newly merged company consolidated its production facilities.

Mark J. Levine, Staff Member

APPENDIX I.—LETTER SUBMITTED BY REVEREND RAWLINGS



ECUMENICAL COALITION OF THE MAHONING VALLEY
225 Elm Street
Youngstown, Ohio 44503

1) Letter signed by Congressman Carney, Mayor Richley, Mr. Lesaganich and Bishop Malone addressed to Mr. Harmon, Mr. Hall and Mr. Embry.

December 23, 1977

Mr. Sidney Harman
Under Secretary of Commerce
Mr. Robert Hall
Assistant Secretary of Commerce
Mr. Robert Embry
Assistant Secretary, Department of Housing and Urban Development
Washington, D.C.

Dear Sirs:

In response to Mr. Hall's pledge, that as soon as one local entity had been established to begin planning for the possible modernization and activation of the closed portion of the Campbell Works of the Youngstown Sheet and Tube, the government would act by the end of the year to release at least three hundred thousand dollars ($300,000.00) in planning money, we wish to inform you of the following:

We are today establishing the Ecumenical Coalition of the Mahoning Valley, Inc. This organization, with our full support, will be the point of contact and single entity to receive all planning money. It will be actively and cooperatively supported by the Mahoning Valley Economic Development Committee, Inc., a group of prominent citizens from all segments of the community, selected by Congressman Carney and chaired by the Mayor of Youngstown. This committee will regularly review the planning work, contribute suggestions, help advise as to coordination with other studies and will actively support and help organize whatever implementation steps become appropriate.

Together we have also unanimously agreed to designate the National Center for Economic Alternatives to manage the planning process under the direct supervision of the Religious Coalition which will contract with it as the sole planning agent. As you already know, Senators Glenn and Metzenbaum have also indicated support for the objectives of our endeavors.

We wish to thank you for your support and the understanding you showed for great speed in this matter. Reverend Edward A. Stanton and Dr. Gar Alperovitz will be in touch to work out the details.

Sincerely yours,

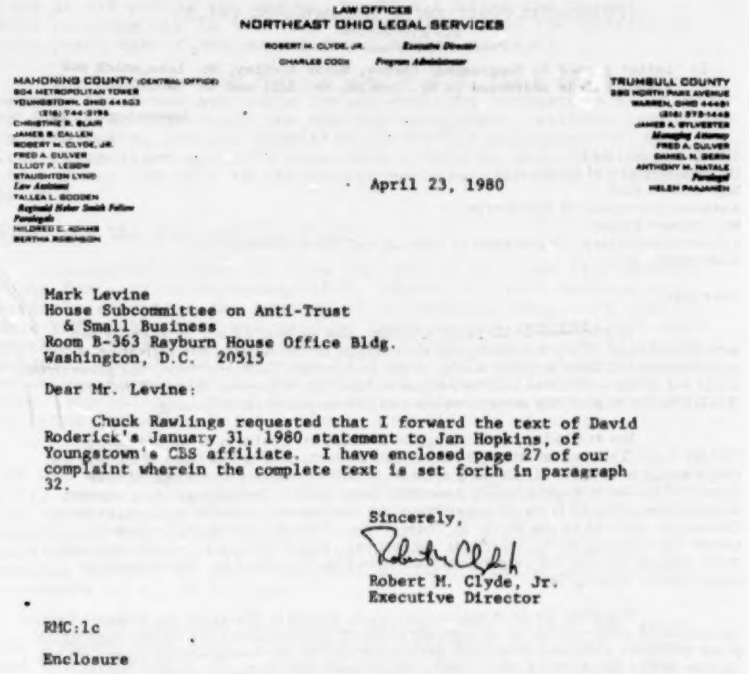
Charles J Carney
Congressman Charles J. Carney
19th District, Ohio

James W Malone
James W. Malone
Bishop of Youngstown
Chairman, Ecumenical Coalition

J. Phillip Richley
Mayor Elect, Youngstown

Frank Leseganich, Director
District 26, United Steel Workers
F. Leseganich

APPENDIX J.—STATEMENT OF UNITED STATES STEEL'S DAVID RODERICK ON EMPLOYEE OWNERSHIP POSSIBILITIES OF CLOSED UNITED STATES STEEL PLANTS



LAW OFFICES
NORTHEAST OHIO LEGAL SERVICES

ROBERT M. CLYDE, JR. *Executive Director*
CHARLES COOK *Program Administrator*

MAHONING COUNTY (CENTRAL OFFICE)
804 METROPOLITAN TOWER
YOUNGSTOWN, OHIO 44503
(216) 744-3196
CHRISTINE R. BLAIR
JAMES B. CALLEN
ROBERT M. CLYDE, JR.
FRED A. CULVER
ELLIOT P. LEBOW
STAUGHTON LYND
Law Assistant
TALLEA L. BODDEN
Reginald Heber Smith Fellow
Paralegals
MILDRED C. ADAMS
BERTHA ROBINSON

TRUMBULL COUNTY
280 NORTH PARK AVENUE
WARREN, OHIO 44481
(216) 373-1448
JAMES A. SYLVESTER
Managing Attorney
FRED A. CULVER
DANIEL N. BERIN
ANTHONY M. NATALE
Paralegal
HELEN PAAJANEN

April 23, 1980

Mark Levine
House Subcommittee on Anti-Trust
  & Small Business
Room B-363 Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Mr. Levine:

Chuck Rawlings requested that I forward the text of David Roderick's January 31, 1980 statement to Jan Hopkins, of Youngstown's CBS affiliate. I have enclosed page 27 of our complaint wherein the complete text is set forth in paragraph 32.

Sincerely,

Robert M. Clyde, Jr.
Executive Director

RMC:lc

Enclosure

32. On January 31, 1980, David Roderick, Defendant's Chairman of the Board, told a television reporter for the CBS affiliate in Youngstown that Defendant would not sell its Mahoning Valley mills to an employee cooperative. Mr. Roderick stated:

> "I don't believe that those are really viable options. We obviously would not be interested in selling the plant to a group of people that could only be successful if they were massively subsidized by the federal government. We're not, in other words, interested in creating subsidized competition for ourselves at other locations."

The reporter asked Mr. Roderick: "So you're refusing to sell?" Mr. Roderick responded:

> "I would certainly not be interested in selling to a coalition that would be subsidized by the federal government in order to keep them into existence."

33. On February 5, 1980, Joseph Dembeck, Defendant's Vice President-Realty, reaffirmed Mr. Roderick's position in testimony before the Select Committee on Small Business of the United States Senate. Mr. Dembeck also stated that, while refusing to sell to a government-subsidizied employee cooperative, Defendant was seeking buyers for at least the Sinter Plant at the Ohio Works, and for the four bar mills and the strip mill at the McDonald Works.

Appendix K.—Remarks by Hon. Berkley Bedell Before the Senate Select Committee on Small Business, February 5, 1980

BERKLEY BEDELL, IOWA
CHAIRMAN
JAMES M. HANLEY, N.Y.
HENRY B. GONZALEZ, TEX.
RICHARD H. ICHORD, MO.
TONY P. HALL, OHIO
TOM STEED, OKLA.

DAN QUAYLE, IND.
OLYMPIA J. SNOWE, MAINE
THOMAS J. TAUKE, IOWA

[illegible]

[illegible]

United States House of Representatives
Committee on Small Business
Subcommittee on
Antitrust and Restraint of Trade
Activities Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

February 5, 1980

TO: Members of the Antitrust Subcommittee

FROM: Marc E. Rosenberg, Staff Director
Small Business Subcommittee on Antitrust

RE: Conglomerate Mergers/Steel Plant Closings

On Friday, February 1, the House Small Business Subcommittee on Antitrust held its second in a series of hearings on conglomerate mergers. Among the cases reviewed was that of the Youngstown Sheet and Tube Company.

At the hearings there was considerable interest in testimony that some of the major steel companies were barring the sale of recently-closed steel mills to local enterprises that were seeking to reopen them. It was agreed that the Subcommittee should contact the Senate Select Committee on Small Business, which had already scheduled hearings on steel plant closings, and attempt to coordinate the activities of the two panels.

At the invitation of the Senate Committee, chairman Bedell testified at their hearing this morning. He was accompanied by Rep. Lyle Williams of Youngstown, who had participated in Friday's hearing in the Antitrust Subcommittee.

For your use and information, I am enclosing a copy of Mr. Bedell's remarks on the subjects of conglomerate mergers and steel plant closings.

BERKLEY BEDELL, IOWA
CHAIRMAN
JAMES M. HANLEY, N.Y.
HENRY B. GONZALEZ, TEX.
RICHARD H. ICHORD, MO.
TONY P. HALL, OHIO
TOM STEED, OKLA.

United States House of Representatives
Committee on Small Business
Subcommittee on
Antitrust and Restraint of Trade
Activities Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

DAN QUAYLE, IND.
OLYMPIA J. SNOWE, MAINE
THOMAS J. TAUKE, IOWA

MARC H. ROSENBERG,
SUBCOMMITTEE PROFESSIONAL STAFF
MEMBER
202-225-[illegible]

KAREN DAVIS HOPPE,
MINORITY SUBCOMMITTEE PROFESSIONAL
STAFF MEMBER
202-225-[illegible]

Remarks by

Hon. BERKLEY BEDELL

Before the Senate Select Committee

on Small Business. February 5, 1980.

Mr. Chairman, I wish to commend you and the other members of this committee for conducting this timely hearing on the subject of steel plant closings. Recently, I have become involved in studies of related matters.

In the House of Representatives I serve as chairman of the Small Business Subcommittee on Antitrust and Restraint of Trade. Currently, we are in the midst of a series of hearings on conglomerate mergers and their effects on small businesses and local communities.

Last week we heard testimony about five cases involving companies that were acquired or divested by conglomerate "parents". One of the cases was Youngstown Sheet and Tube, which was acquired by the Lykes Brothers steamship company, which itself became a part of the LTV conglomerate.

Today I would like to share with you some of the facts that came to light at our hearings last week, as well as my personal observations. I believe this information may be helpful to you as you consider the situation in the steel industry.

Government economists accurately predicted in 1969 that Youngstown Sheet and Tube would have to shut its doors within 10 years if Lykes took it over. The reason was that Lykes had huge demands for cash to service the loans it took out to purchase Youngstown, and it needed cash to buoy up other divisions that had poor cash flow. This draining away of cash from Youngstown precluded necessary capital improvements and resulted in the Ohio facilities becoming obsolescent. Moreover, the company no longer had the cash reserves needed to survive in a highly cyclical industry.

This pattern is not unique to Youngstown Sheet and Tube or to the steel industry. In our hearings we heard of similar cases involving book publishing, industrial machinery production, razor blade manufacturing and beadspread weaving. In each case the parent company decided that it could obtain a better return on its money somewhere else and either divested itself of its subsidiary or sold off the assets and liquidated the unwanted division.

It appears that in many cases the problem was not that the subsidiary was not viable. Instead, the problem was that the parent company could make more money doing something else or that the tax laws made plant closings a financially attractive alternative.

All of this becomes relevant to the steel plant closings that you are considering when we look at what the steel companies are saying to the Congress. According to news accounts in last Friday's papers, the major steel companies are saying that they need three things right away.

These are: 1) more protection from foreign competition; 2) tax law changes to allow faster depreciation of their assets; and 3) permission to continue polluting our air and water. The last item, I think, was thrown in for good measure: I will focus my remarks on the other two points.

It seems clear to me that one of the reasons why American steel facilities are not competitive in the world market is that the conglomerates that own them are not reinvesting the capital necessary to keep them competitive. I already have mentioned the Lykes Company's diversion of Youngstown Sheet and Tube's cashflow into steamships and debt-servicing.

My Subcommittee staff looked at U.S. Steel recently and noted that, according to Business Week magazine, in the past three years U.S. Steel increased its steel assets by 13 percent. At the same time its non-steel assets increased 80 percent. While the company's steel assets were growing at less than the rate of inflation, it was building new petrochemical plants, engaging in new joint ventures looking for oil in South America, building a major testing facility for jet aircraft, expanding its mining operations, engaging in various investment and real estate ventures, etc. U.S. Steel is well on its way to becoming a conglomerate in which steel is one of its less profitable investments.

If the Congress grants the big steel companies the accelerated depreciation they seek, I think we must build into it a roll-over provision, to assure that the money stays in the same industry. If we do not do this -- if we instead say, "Here, the government wants you to keep this tax money you owe, and we want you to spend it any way you please" -- then we will just be hastening the further decline of our steel industry, because we've seen that that really is not where they like to put their money lately. In my opinion, if accelerated depreciation is granted without a roll-over provision, then conglomerates will simply take money out of steel mills all the more quickly and move it into insurance or chemicals or tugboats or whatever else they fancy.

One final point that I wish to raise, Mr. Chairman, is that last Friday we heard testimony that some of thesteel companies that have closed their plants recently have stated that they will not sell those plants to employee groups or others who seek to reopen those facilities. The argument they are making seems to center on the fact that they don't want to help create new competitors for themselves.

We have not yet had time to check out this report fully. Personally, I hope it turns out that the report is not accurate.

I say this because I would be very disturbed to know that companies are coming to Washington asking for help because their plants cannot meet foreign competition, and then knowing that those same companies are afraid someone else could possibly take those same plants and make them competitive. I would also be disturbed if it proves true that the steel companies are asking for further restrictions on imports and at the same time are closing down domestic plants and refusing to sell them to others who could thereby help increase domestic production. And I also would be disturbed if it proves true that the members of an industry populated by fewer and fewer companies are erecting barriers to entry by new firms.

Mr. Chairman, I think the steel industry has some serious problems. And I will support government assistance if I think it is targeted properly at those problems. But I believe we must be careful, lest we be stampeded into taking expensive steps in the wrong direction.

APPENDIX L.—MATERIAL SUPPLIED BY HON. LYLE WILLIAMS; RE YOUNGSTOWN SHEET AND TUBE

LYLE WILLIAMS
19th District, Ohio

MEMBER:
COMMITTEE ON GOVERNMENT
OPERATIONS
COMMITTEE ON SMALL BUSINESS

Congress of the United States
House of Representatives
Washington, D.C. 20515

[illegible] Longworth House Office Building
[illegible]

District Offices
[illegible] Youngstown Road, S.E., Suite [illegible]
Warren, Ohio [illegible]
(216) [illegible]

[illegible] West Federal Street
Youngstown, Ohio [illegible]
(216) [illegible]

[illegible] State Street
Struthers, Ohio 44471
(216) [illegible]

February 7, 1980

The Honorable Berkley Bedell
Chairman, Subcommittee on Antitrust
Committee on Small Business
U.S. House of Representatives
B-363 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I have been following the Antitrust Subcommittee's hearings on conglomerate mergers and their effects on small business and local communities with great interest. As the representative from the Youngstown area of Ohio, I can attest to the great dispair a major plant closing can bring to an area.

I appreciated the opportunity to sit with the Antitrust Subcommittee during the February hearing that featured witnesses from the Youngstown community. I believe the discussion of the mergers involving the Youngstown Sheet and Tube Company, and its subsequent closing, will enhance your hearing record.

For your use and information, I am enclosing two transcripts of The MacNeil/Lehrer Report, "Employee Ownership", and "Sad Days in Steeltown". These transcripts provide excellent discussion of the Youngstown dilemma, and I recommend that you consider including them in your hearing record.

Sincerely,

LYLE WILLIAMS
Congressman
19th Ohio District

LW:db

FROM Thirteen
356 WEST 58th STREET
NEW YORK, NY 10019 (212) 560-2000

Library #691
Show #3231

THE MacNEIL/LEHRER REPORT

"Employee Ownership"

In New York

ROBERT MacNEIL	Executive Editor

In Washington, D.C.

JIM LEHRER	Associate Editor
Rev. RICHARD FERNANDEZ	Director, Save Our Valley Fund
JOHN BLANCHARD	Employee Ownership Advocate

Thanks to
Vermont Public Television
"Blue Collar Capitalism"
Produced by
JOELLE SHEFTS

Producer KENNETH WITTY	Reporter LEWIS SILVERMAN

Funding for this program has been provided by this station and other Public Television Stations and by grants from Exxon Corporation, Allied Chemical Corporation and the Corporation for Public Broadcasting.

WNET/WETA Air Date: May 22, 1978

ALL RIGHTS RESERVED.
COPYRIGHT (c) 1978 BY EDUCATIONAL BROADCASTING CORPORATION AND GWETA. THIS TRANSCRIPT MAY NOT BE REPRODUCED IN WHOLE OR IN PART BY MIMEOGRAPH OR ANY OTHER MEANS, WITHOUT PERMISSION.

THE MacNEIL/LEHRER REPORT Air Date: May 22, 1978

Transcript of "Employee Ownership"

Copyright 1978, Educational Broadcasting Corporation and GWETA

ROBERT MacNEIL: Good evening. When the Lockheed Corporation faced bankruptcy in 1971 the federal government bailed it out by guaranteeing loans totalling a quarter of a billion dollars. Some critics called it welfare for the giant corporation. Now the government is being asked to do the same thing for a large Ohio steel mill that actually closed down last year. The difference is that the employees who lost their jobs and the local community want to take over the plant and run it. The idea of employee ownership has been attracting more attention recently, as big conglomerates have shut down subsidiaries. Employee ownership has been tried in many places. Sometimes it works, and sometimes it doesn't. Tonight we look at employee ownership in Ohio, Vermont and Massachusetts: can the workers succeed where managements failed, and should the government help them try? Jim?

JIM LEHRER: Robin, the steel mill of the big dream is in the Youngstown, Ohio area. It's the Campbell Works of the Youngstown Sheet and Tube Company, shut down last fall with 5,000 employees losing their jobs. We went to Youngstown last winter, and you may recall the story we did then on the impact the massive layoffs were having on the financial and psychic health of this old-time steel community in the Mahoning Valley of Ohio. There was talk then of the community's taking over the plant, but it was hard to take it too seriously; the odds seemed enormous. But the effort has continued at full speed since then. There was a recent government study, for instance, which concluded it would be feasible to make a go of it, but it would take from $525-$730 million to modernize the plant first. That's where the federal government comes in -- at least, that's where the leaders of the drive hope it'll come in.

The director of one part of the campaign, called Save Our Valley, is the Reverend Richard Fernandez, a United Church of Christ minister. His effort is sponsored by the Ecumenical Coalition of the Mahoning Valley, which is spearheading the overall push for community takeover of the plant. Reverend, what's the master plan for buying the plant and then getting that $525 million or so to take it over and then re-open it?

Rev. RICHARD FERNANDEZ: I'd say the master plan has about three or four parts. One of course was the research that we had done by the National Center on Economic Alternatives through a HUD grant. Another part that we've been deeply involved in in the last four months has been mobilizing the community to literally put earnest money into the banks of the Mahoning Valley -- it's up to $1.7 million today -- to, in a sense, show the people around the nation that this is going to be a showcase of community effort even before we go to the federal government for some assistance.

LEHRER: Now, this is the program where you're asking people to put money in special savings accounts, right, not money that'll actually be used, but it's just a symbolic show of support, is that right?

FERNANDEZ: Well, it's symbolic in the sense that we need to know in advance how much money is in the Mahoning Valley and national church agencies -- at least a guess of how much money will be available to take over this mill, in the Valley. We need money from other places, of course. We see this campaign about ready to peak, because we just went through a weekend where we made 54,000 phone calls in the Valley, literally to every resident of five communities, followed up by a mailing piece. So that's the...

LEHRER: How much money do you want to get in that particular program?

FERNANDEZ: When we began the campaign we said we needed somewhere between four and fifteen million dollars in the bank, and 8,000 to 15,000 participants, and we think by July first we'll be in about the middle place of both of those numbers.

LEHRER: Okay. Assuming you make it, then what's the next step?

FERNANDEZ: Well, of course these steps are built into each other. Even now we're involved in trying to set up a meeting with the President, because we need to talk with him now, not about concrete, specific amounts of money but at least to get his permission to move quickly with various agencies in the federal government to begin to look at the study that's been prepared, the feasibility study, to begin, in a sense, to talk very nuts and bolts about what it means to put a very heavy industrry and 5,000 women and men back to work in the plant.

LEHRER: So what is the basic pitch you're going to make to the President? Why should the President do this?

FERNANDEZ: We think the President should do this because I think that as we look at urban America today we're looking at the loss of jobs, the flight of capital all over the country. And we believe that Youngstown, as well as some other communities, has the potential of being a showcase for the nation. It's the first time that a heavy industry will be taken over by community and workers. And we think that if this could be done successfully, it will have multiplication effects, literally around the country.

LEHRER: Wouldn't one of those multiplication effects likely be when other plants close -- and there are many other plants that close throughout the United States besides those in Youngstown -- will do the same thing and they'll also be coming to the federal government wanting to say, "Hey, look, help us put this plant back to work"?

FERNANDEZ: I think you'll get a mixed situation there. I think there are some plants that are not so heavy into machines and heavy equipment, that will have the resources locally, or at least regionally, statewide, to come up with the funds necessary to buy out an old employer or a closed-down mill. I think certainly there will be other instances where you need so much capital, as in the steel industry, where of course the federal government may be asked again. But we think that this is an alternative that speaks to the future in terms of jobs and employment in the country, and we hope -- we'll hear more about that later -- that there'll be other smaller and perhaps even larger projects as we move on, some needing federal help and some not.

LEHRER: Why do you think that the community, the employees can run that plant better than management was able to?

FERNANDEZ: Well, I'm not sure that we'd quite put it in that kind of polarized terminology, "better." I think that what we do know is that when the Lykes Corporation became involved in Youngstown almost nine years ago now, there was a lot of modernization that needed to take place. For a variety of reasons, known best to them, it was not modernized. And so, slowly but surely the mill began to lose money. It was not a money-losing venture when they took it over. It's our view that it makes no sense to take over that mill in the present situation unless you have clear plans to modernize it. And indeed, that's what the feasibility study was based on.

LEHRER: And that's what the federal guaranteed loans would do, modernize the plant.

FERNANDEZ: That would be part of the entire picture, sure.

LEHRER: But the plant could have made it if the federal government had been willing to underwrite loan grants for the original corporation, and the same thing would have held true, is that not correct?

FERNANDEZ: Yes, but I think there's a key issue that we're concerned about right now in the Mahoning Valley in Ohio, and that is, we want to in a sense say that when you are into community redevelopment, when you want to put a company back on its feet, the first place to begin the work is in the valley or in the community. The first place is not the federal government. We think that the kind of effort that's gone on in that community can be utilized in other places in terms of organizing, and in many instances they will never have to go to the federal government. They may not even have to go to state governments for added monies. So we think simply to bail out a Lockheed, for example, does nothing in terms of self-help and self-reliance -- key words, we think, in terms of the way the country was originally put together.

LEHRER: All right, thank you. Robin?

MacNEIL: Youngstown is a place which wants to try employee ownership. Now let's look at a place where it's actually been tried, the Vermont Asbestos Group mine at Lowell, Vermont. It was taken over by the workers in 1975, as we see in this excerpt from the Vermont Public Television documentary, "Blue Collar Capitalism."

> NARRATOR: The GAF Corporation once owned this asbestos mine in northern Vermont -- a small operation for GAF, but to the miners it was a way of life. In April 1973 the EPA ordered GAF to install expensive anti-pollution equipment within two years. In response, GAF announced that when the deadline came they'd shut the mine down rather than comply.
>
>> JOHN LUPIEN, Former Board Chairman: In the last five years I was involved with two places that had to shut down, and each and every time it hurt me very much; even if I had to transfer and all I had to do was to pack again and go to another place, I felt that the people were miserable.
>>
>> I thought it was some kind of a disaster for the employees, for myself, for everybody involved in this area. I felt that some-

thing had to be done, and my first thought was, if they don't want to operate, let's buy it. Let's buy it.

I did all my planning, and then I presented it to the workers. They couldn't believe that it could be done, and they couldn't believe because I was new up here and that was a new idea. That was something that they've never heard about, discussing the purchase of this mine, discussing millions of dollars with people that are used to dealing with hundreds of dollars. They couldn't accept it, they couldn't see it possible.

RICHARD HAMILTON, State Official and Former Board Member: In trying to put together the financial package to allow the employees to buy the mine, we ran into some rather extreme frustrations in that until we had a hundred percent guarantee by the state through Vermont Industrial Development Authority of the loan, we just were unable to get any financial institution to consider the loan seriously. Every question became special, simply because it involved employees making the purchase.

NARRATOR: But having won a year's extension from the EPA, a consortium of banks finally agreed to loan one and one half million dollars. $400,000 more was loaned by a local bank, and GAF gave a credit of $250,000. In just two weeks the workers raised $78,000 among themselves. They bought eighty percent of the shares of a new corporation known as The Vermont Asbestos Group. Everybody from janitor to foreman bought at least one share worth fifty dollars; the average was six. A new and unique board of directors was elected. Of the fifteen members on the new board, seven including Lupien were chosen from management. Seven more were chosen from among the hourly paid men -- workers, union members. The only non-employee elected to the board was Alvin Warner.

A year after the purchase, this union meeting was called to vote on management's first wage offer, but the subject gets a lot more complicated when the men -- and their union board -- are negotiating with fellow owners.

MEETING CHAIRMAN: I'm going to start right in by laying it on the board, boys. You have been offered seventy-two cents an hour as a package unit. What kind of a reaction do I have out there for seventy-two cents?

SEVERAL WORKERS IN UNISON: No good.

CHAIRMAN: No good.

FIRST WORKER: We never negotiated with GAF and ever in our life ever got a seventy-two-cent package. We never got a seventy-two-cent package with GAF.

SECOND WORKER: Yeah, but you never owned stock in that place, either.

THIRD WORKER: We don't work for GAF any more.

FOURTH WORKER: I read in a couple of papers they had $500,000 they were looking to invest in another company. All right, instead of investing in another company, how about giving it to the guys in this company?

NARRATOR: In the first year, a totally unexpected thing happened: hooker fibre became scarce. Other suppliers in the United States and Canada were plagued with mudslides, strikes, and closures due to EPA demands. Prices were soaring. Management used the profits to pay off the loans within the first nine months. Next, the pollution equipment was purchased and installed -- all ahead of schedule. But these unexpected profits have been disruptive as well. The touchy question of how profits should be invested and just who should make those decisions splits labor and management.

MEETING CHAIRMAN: The boys want the money, they're the majority of the stockholders.

WORKER: It's our money!

CHAIRMAN: Right.

ALVIN WARNER, State Representative and Board Member: Many of the workers of course have read that there are large profits, and many of the younger workers, of course, would like to see this used as wage increases. But we can't think of just today, at the present. We have to look down the road five or ten years after the depletion of the mines, as to invest into something that will take the place of the mine. I don't think the workers could ever be educated to the point where they would be qualified, all of them, to make these decisions as to where the money should go.

NARRATOR: Many of the workers have no confidence in their own ability; they don't want to be involved. But some are bitterly disappointed at the lack of worker involvement. One is Marcel Faucher.

MARCEL FAUCHER, Mine Worker: When we ask for information of the things that went on during the board of directors meetings, we don't get any answers, so it causes a clash.

When the board of directors have a meeting, it's all classified, it's all confidential. You can't get anything out of them; they won't speak up. One thing I've noticed, the minutes of the board of directors meetings, they're extremely vague.

The attitude of management is as it always has been: keep the laborer down and don't inform him of anything, don't let him participate in anything.

WARNER: I think the biggest problem in the changeover is to get management to realize that they're not working for some big conglomerate any more, that they are working for the stockholders, and the stockholders are the employees.

WORKER: How are they going to vote on this now? You have to accept it.

MEETING CHAIRMAN: Then officially you have rejected the seventy-two cents that was offered us. (Applause.)

The next thing to do is to take a strike vote. And let me clarify this, boys. A strike vote only gives us a position, it doesn't mean you aren't going to work Monday morning. When you'd ever use it, I don't know. And I don't think it would ever come to that. I'd be the last one to want it.

FIRST WORKER: How about that?

SECOND WORKER: But you have a chance to accept the next offer they give you.

THIRD WORKER: Accept or reject, same as you did here.

FOURTH WORKER: But what if they don't make any other offer?

SECOND WORKER: Then you strike.

FIRST WORKER: Then you strike.

MacNEIL: Well, they didn't strike. But mistrust grew over management plans to go ahead with investment in a subsidiary plant. The president was fired, and in the middle of the feuding, takeover bids began to come in. Worker who bought shares for fifty dollars three years ago were offered more than $1,800 a share. Some workers sold out to a local contractor, Howard Manosh, who amassed a big enough bloc to run his own slate of directors and take control. So while many workers still own shares, they no longer run the company.

Recently producer Ken Witty went to Vermont to see how those involved feel now about this experiment in employee ownership.

MARCEL FAUCHER, Mine Worker: Well, it wasn't so much the employee ownership that was the problem. The problem was who was managing it and their attitude. The intention of whoever is in control is what makes or breaks the thing.

We were disregarded right along, you know; we were nothing. You know, you punch in and do your work and shut up.

KENNETH WITTY, Producer: So if Howard Manosh manages the mine well, no one would mind if he owned the whole thing.

FAUCHER: Right, right. The attitude that I find that the boys have is that hell, if Howard's going to do such a good job, if he's such a great guy, I don't want any part of it; here, he can have it. Because we get along good with Howard. Howard is the type of fella who'll come out as I'm dressed here, right into the mine. He has; he's already come. He's been in the mill three o'clock in the morning, he came over at ten or eleven o'clock one night (unintelligible). And we can go up to him and talk to him. He'll come to us to talk to us, you know. Hiya, Marcel, how are you. He's the type of fella who integrates himself. So outside of a fella wanting dividends, why should he own it if Howard's going to be such a compatible owner?

RICHARD HAMILTON, State Official and Former Board Member: What gnaws at me is there aren't too many times in the complex world we live in where just the normal everyday working man gets the opportunity to own and control his work place. There must have been something more we could have done. I don't know just what it would have been, I just feel that we missed an opportunity somewhere.

ALVIN WARNER, State Representative and Board Member: If any other company did decide to go this route, that they would take lessons from our weaknesses, which is putting a lot of the workers on the board that have perhaps a feeling of looking out for their own personal gain. I think it should be outsiders, businessmen with experience, bankers, which our new board consists of.

JOHN LUPIEN, Former Board Member: There's no doubt that the board of directors, the first board of directors, were no experts at acting as directors. So there was the need for a period of time to really learn how to deal with the different situation. They have done real good, because you make a comparison to any company in America, and I'm sure that anyone, any stockholder that would see his stock value increase forty times in three years, they would not fire the board.

WITTY: How would we rate this? A failed experiment, a successful experiment?

LUPIEN: No. No, it is not a failed experiment. The main purpose what we have worked at doing four years ago was primarily to save the job for each and every one of these employees. If they have decided otherwise today in regard to the ownership, that is their right.

FAUCHER: I guess the employee ownership bit has kind of gone with the wind. It's not really important, I feel, at the mines. Maybe it would be under different circumstances. It's a whole hassle. Fellas don't want any part of it, they just want to come in, punch in and go to work, punch out and go home.

MacNEIL: One more footnote: John Lupien, who thought up the employee takeover and became board chairman, is now involved in another offer to regain control, this time for $2,200 a share. So the fortunes of Vermont Asbestos and its workers remain up in the air. Jim?

LEHRER: Attempts at employee ownership of dying or dead businesses have been springing up all over the country. Another one that has gotten some public attention is in Clinton, Massachusetts, site of President Carter's first Town Meeting. The day after the President left Clinton it was announced that one of Clinton's major employers was going out of business. It was the Colonial Press, Incorporated, a book manufacturing company which employed 1,800 people. Now a group of former employees is attempting to re-open it, with the help and guidance of the Industrial Cooperative Association, a Massachusetts-based non-profit group set up to provide such assistance. John Blanchard, who is a staff member of the American Friends Service Committee, is the association's coordinator working on the Clinton project.

Mr. Blanchard, are you going to have some of the same problems that they had in Vermont, or have you set up some way to avoid them?

JOHN BLANCHARD: Well, in a sense yes and no both, I guess we have to say. First of all, I guess one of the ways in which we see that we've got some different problems is that it's going to be starting off as a smaller business, a scale down from the former size. The new book business there will only begin, in a sense, in first stage with a small number of employees....

LEHRER: Of the original 1,800, how many will go to work in the first stage?

BLANCHARD: In the first stage probably only fifteen. Within a year that's expected to change to perhaps sixty to seventy-five workers. And two different stages of the operation, as well. So it will be in part a starting all over again on a smaller scale.

LEHRER: Is it a sure thing at this point? I mean, are you definitely going to re-open the plant on a certain date?

BLANCHARD: Yes. Well, it's as sure as we can be at this point in terms of its plans and finances, and we are quite sure of them -- to begin with, at least -- and we see that first stage as, again I should say, a starting point for expansion later. The first stage will be only with the one step of the business that is typesetting and composition, and then about four months later the book printing and bindery part of the operation would come in; that's slated to begin by January or February of '79.

LEHRER: What about the point that was raised by the Vermont man that they made a mistake at the beginning, they had too many of the employees on the board who were not experienced managers and they should have brought in outsiders at the beginning. What are you going to do in your case?

BLANCHARD: Well, there's no doubt about it that the employee-owned business has to have competent management and enough expertise, both within the board itself, within the management team itself, and if need be they probably are going to want to have some expertise from outside. I wouldn't put the problem quite the way that they see it or that they seem to say and talk about their problem in Vermont. I would say that the situation is somewhat different in Clinton in the sense that they both feel they are going to need competent management within the board, some help from outside, but there will be some other things going for them in this kind of a structure. We are advocating, as outside consultants, to change the structure of the company in a significant kind of way. By that I mean we will separate the way employees invest from the way they vote control, and in this kind of a corporation or cooperative as this will be, each worker will have an equal vote, including workers and management.

LEHRER: Regardless of how much stock they own.

BLANCHARD: Yes.

LEHRER: I see. Would you not agree, then, with the man there at the end who said that employees are only concerned with one thing, and that's their job, and going in and working and punching the card, and that ownership doesn't really mean that much in and of itself?

BLANCHARD: That's only partly true, and they're not going to be too much interested in the ownership if they see themselves pretty much dominated...

LEHRER: Regardless of who's doing the dominating.

BLANCHARD: Yes; yes.

LEHRER: I see. All right. Robin?

MacNEIL: Back to you, Reverend Fernandez, do some of these not act as cautionary tales for you? Do they give you any concerns, the difficulties in Vermont, or the caution with which the Clinton, Massachusetts cooperative is being approached?

FERNANDEZ: I guess I have to say that when you begin to see if you can raise from the ashes a steel mill that's in the ball park of $550-730 millon, it almost sounds like you threw caution to the wind at the outset. My own sense is that we learned from the asbestos plant in Vermont, we learned from the work in Clinton, the South Bend Lathe Company, work place democracy in a number of major corporations, including the Kaiser Steel Company on the West Coast; and I guess what we're saying is, there are always some risks involved, whether you're into a very traditional corporate structure, or in this sense that we're involved in Youngstown, into something that in some ways is new. We're looking for a way, very frankly, of saving jobs, of halting the flight of capital, both from major urban centers and the country generally, and I don't think you do that without some trial and error, without some pain, without some difficulty; and we have set about in the Mahoning Valley to see if we can't forge a new steel mill that's under some form of community-worker ownership, knowing in advance that it will not be foolproof, but perhaps we will have a different set of problems to work with and to deal with than a normal corporation under normal control.

MacNEIL: Let me ask you both in conclusion, starting with you, Mr. Blanchard, if these concerns that you both want to organize with the workers owning them, if they are potentially profitable, why isn't private enterprise ready -- since private enterprise is interested in making a profit -- why isn't it ready to come in and take them over and do it? Have to seen some profitability they don't, or what is the difference?

BLANCHARD: Well, in the case of Clinton, it may be you have to look back into a little bit of history of the '60s and the way in which many conglomerates grew; many of the larger corporations, in attempting to merge and add to their businesses, picked up smaller companies that were not a part of their main line of business. And this is the kind of case which we're referring to in the case of Colonial Press. The parent company was very interested and its main line of business was quite different than book manufacturing and book printing.

MacNEIL: I have to leave it there, Mr. Blanchard, I'm awfully sorry; and I didn't have time to get back to you, Reverend Fernandez, I'm sorry. Thank you both for coming this evening. Good night, Jim.

LEHRER: Good night, Robin.

MacNEIL: That's all for tonight. We'll be back tomorrow night. I'm Robert MacNeil. Good night.

FROM THIRTEEN
356 WEST 58th STREET
NEW YORK, NY 10019 (212) 560-2000

Library #633

Show #3173

THE MacNEIL/LEHRER REPORT

"Sad Days in Steeltown"

In New York

ROBERT MacNEIL Executive Editor

In Washington, D.C.

JIM LEHRER Associate Editor

Photography WALTER BREDEL	Film Editing BOB JACKSON
Audio Recording LANNY NASS	Sound Editing DENNIS MEYERS
Research MARJORIE CHAMBERLAIN	Photo Animation PETER SCANNELL
Producer KENNETH WITTY	Reporter LEWIS SILVERMAN

Funding for this program has been provided by this station and other Public Television Stations and by grants from Exxon Corporation, Allied Chemical Corporation and the Corporation for Public Broadcasting.

WNET/WETA Air Date: March 1, 1978

ALL RIGHTS RESERVED.
COPYRIGHT (c) 1978 BY EDUCATIONAL BROADCASTING CORPORATION AND GWETA. THIS TRANSCRIPT MAY NOT BE REPRODUCED IN WHOLE OR IN PART BY MIMEOGRAPH OR ANY OTHER MEANS, WITHOUT PERMISSION.

THE MacNEIL/LEHRER REPORT Air Date: March 1, 1978

Transcript of "Sad Days in Steeltown"

Copyright 1978, Educational Broadcasting Corporation and GWETA

LEN BALLOCK, 21 Years of Service: I had twenty-one years down there. In the last couple of years I kept on thinking: nine more years, I'll be set; I'll retire, my house is paid for and everything else, my kids will be at the right age and everything else -- and now what have I got?

JOHN BRACAGLIA, 34 Years of Service: I see right now there's families having troubles. Men are drinking, where they usually don't drink; good workers, good men.

ED BUTCH, 12 Years of Service: The unknown future -- not knowing when you're going to get a job, where you're going to get a job, is the hardest thing to take.

ROBERT MacNEIL: The words of unemployed steelworkers in the Youngstown, Ohio area. Tonight, the impact of massive layoffs in Steeltown, U.S.A.

Good evening. Three eastern Congressmen today asked the House of Representatives to help save communities from the economic and social disaster of factory closings. Their bill would encourage workers and community groups to use government loans to take over and run industries closed as unprofitable by distant corporations. In introducing the measure, Democrat Peter Kostmayer of Pennsylvania said it was intended to rescue communities like Youngstown, Ohio -- one of the ailing centers of the U.S. steel industry. Last September 5,000 workers lost their jobs when Youngstown Sheet and Tube, pleading falling profits and foreign competition, closed down. Another 6,100 steelmen may be thrown out of work if U.S. Steel follows suit, as it may, and if two other plants merge.

We've been wondering for some time what happens to a community like Youngstown, which lives on steel, when its industrial heartbeat stops. What does it do to the men, and their families, and the small businesses, and the churches? Tonight, sad days in Steeltown. Jim?

JIM LEHRER: The talk in steeltowns like Campbell and Struthers, Ohio has always revolved around the mill. The massive Campbell Works of Youngstown Sheet and Tube Company dominate the landscape and the conversation in these parts. But with the mill mostly shut down, unemployment benefits have replaced shop talk as the topic of conversation at the union hall. There's a whole new vocabulary with strange terms like SUBs and TRAs. SUBs is short for Supplemental Unemployment Benefits. These are paid by the company over and above unemployment insurance. The SUB funds were set up for short, temporary plant closings, and with thousands laid off since September, the SUB funds are running out. Since January 1, only workers with twenty years or more service are still drawing on these benefits.

TRAs stand for Trade Readjustment Allowances. Essentially they are weekly benefits paid by the federal government to any person who has lost his job due to foreign imports. TRA payments run from one year up to seventy-eight weeks and equal seventy percent of a worker's wages when added to unemployment insurance.

These total benefits equal a financial cushion that is easing the adjustment for thousands of steelworker families. That cushion also makes the impact of layoffs more difficult to assess. But as producer Ken Witty and reporter Lew Silverman found out during several snowy days in the Youngstown, Ohio area, it's not immediate financial want that's worrying people. What's at stake here is a way of life, a man's own sense of self-worth.

BALLOCK: We don't want the damn welfare that we're getting. I get a lot of money right now, from the state, from the Supplemental Unemployment Benefits, and I get it from the TRA. I get a bundle of money. But I don't want this damn money. I want that place to re-open; I want to make steel.

When I see 400 men of my department -- I'm the elected representative of that -- when I see them walk out with no jobs after anywhere from two to twenty to thirty years' service down there, giving their lives -- and these men are experts; we are experts in steel -- and when you say, Do you think this is going to happen, it's not a question of whether it's going to happen, it has to happen. The government has to pump money into there, we have to re-open that plant right down there, or you're talking about 15,000 jobs. Listen, you take ten to fifteen thousand jobs out of this valley, you're going to have a ghost town in Struthers and Campbell, and Youngstown's going to be hurting. And the people around here right now are fed up with the government. They're fed up with Carter and the whole damn bunch. You can give several hundred million dollars foreign aid to a small country, you can spend billions of dollars sending men to the moon and everything else; damn it, it's about time that you concentrated down here, because if it doesn't stop here -- it has to stop right here, in Mahoning County. It has to stop here, because if it doesn't stop here it's going to spread all over the place. We were screwed, royal. My own particular case, with twenty-one years, forty-eight years old. I have to look out, I have two small kids. I have to look out for myself. If nothing happens, say, around August, then I'm going to head West and I'm going to try and find a job out West. Because I have to look out for my family. If nothing happens around here, say by that time if there isn't anything concrete, I'd say by August or September, well, then we have no hope.

LEHRER: Among the unemployed the impact isn't shared equally. Veteran workers are eligible for early retirement. The younger men have no such assurances. Talk among them is about leaving, but there are mixed feelings.

ANDY LONGO, 11½ Years of Service: I myself have had job offers, mostly all out-of-state work. But since I have a new home under construction I haven't been able to leave to even look into them. But some of them have left me an open offer to come whenever I get straightened out. It's quite a move, just the idea of picking up and moving out altogether, you know, family and everything, selling; it's a bigger step, I think, than a lot of people realize.

Most people really don't want to leave, you know, especially if you've been here all your life. About the last thing you want to do is pick up and leave, even if you do get a better job offer somewhere else, you know. You go somewhere, especially if it's a long ways off, like these offers I've had, they're a thousand, 1,300 miles away. Yeah, I've got offers, but you go there, you don't know anybody at all. You've got to start all over again. I think that really is the hardest part, is picking up and leaving.

JIM STEVENS: My name is James Stevens. I'm twenty-eight years old. I just turned twenty-eight. I was hired by Sheet and Tube on my eighteenth birthday, and expected to retire on my forty-eighth. Unfortunately, I don't think that's going to be. I not only want to stay in this area, I'm almost forced to have to stay in this area.

KENNETH WITTY, Producer: Why is that?

STEVENS: Well, if there's no one to purchase my home, I have to stay here. One of my plans is to go into business with a friend of mine and maybe build a few homes. My only worry is, is there going to be anyone here to buy those homes?

LEHRER: Jim Stevens and Andy Longo are skilled workers. Andy is a welder; Jim is a carpenter. Other men without special trades are even less certain about the future.

WITTY: Has this been a sort of crisis for you?

JOE CARCHEDI, 9 Years of Service: I'll say it has. You don't know which way to turn. I've been laid off before and been able to accept it. But when they tell you you're on unemployment and then they tell you your job's gone, it's a little different story. If they tell you you've lost your job and you cry about it, well, I'm not going to cry about it, it's just a fact of life.

EDDIE TUCKER, 10 Years of Service: The way I feel, I mean, you know, it was a hard blow to everybody. People got families, homes to pay for, stuff like that. It's just a big hurt.

WITTY: What are your plans?

TUCKER: My plans? Well, I don't have any plans as of the moment, right now. Just wait and see what happens before I make a move.

LEHRER: Electrician Ed Butch, at thirty years old, was a twelve-year veteran at the Campbell Works. But Ed is another one of the luckier men; his experience makes him readily employable -- if he relocates. But Ed has a special problem.

BUTCH: The house I have right now is the house that me and my wife talked about when we were going together, before we got married; and it takes a lot of work, a lot of money to establish yourself and get what you've always wanted. The house that I have right now is our dream house. We don't want to give it up, but as young as I am, it may be a necessity, because of the fact that there aren't any jobs around here, to move. Like I said, I was interviewed in Tennessee; if I have to, I'll move to Tennessee. And I'll never have my dream house again.
We felt, for Christmas this year, in '77, that we would go all out. We spent more on our children this year than we've ever spent because we don't know what next year will bring.

WITTY: Have you noticed any psychological effects on you, your family, your friends?

BUTCH: Yes, the tensions between me and my wife -- I've been married for, it'll be eleven years in June and we've never had any problems, thank goodness -- but the tensions right now are...we're at each other's throats more often. Me being home, the time, I suppose, that I'm spending with her and the kids, it's hard on both of us because the pressures that are there, the unknown future, is the most drastic part. It's terrible. And up at the union hall here I've talked to several of the people that I worked with and a couple of them have mentioned problems -- wives leaving them, and so forth -- that it's tragic, and I know if no other sales are up in this area, alcohol sales will be up -- I really think so -- using that as a crutch. I'm not yet, thanks, but it's a traumatic shock.

BRACAGLIA: A man's worried about the family, but the pressure right now on a lot of young guys the wives are putting, they're worried, what's going to happen in the next six months, seven months? And meanwhile, it's eating him, but he can't do nothing about it. It's going to turn out either he'll get ulcers, going to get sick, who knows? Desperate enough to steal.

LEHRER: As one of the senior men at the mill, John Bracaglia is not affected. He will retire with a pension. But as a second-generation steelworker with a steelworker son also laid off, he's worried about the future.

BRACAGLIA: President Carter better do something. All the people we have in Campbell, I would say ninety percent of them work in the steel mills -- not Youngstown Sheet and Tube, but Republic Steel and all. Without the steel mills, there is nothing. What is going to happen? People are saying there's a lot of work

> down in Texas, there's a lot of work in Colorado, there's a lot of work in Louisiana. What if everybody in Campbell does that, takes off and leaves? Then what's going to happen? What's going to happen to my home town, the town I love?

MacNEIL: John Bracaglia's home town, Campbell, and its bigger neighbor, Youngstown, are located in the northeastern part of Ohio. There, the Mahoning Valley stretches for thirty miles near the Pennsylvania border, midway between Pittsburgh and Cleveland. One of the area's most serious problems is its landlocked location: sixty-five miles from Lake Erie, thirty-five miles from the Ohio River. Without easy access to waterways, steelmakers suffer sharply higher transportation costs. Railroads in the region are in disrepair, and trucking is very expensive when it comes to shipping steel. A canal to the Great Lakes was planned in the 1930s, but never built.

Ironically, steelmaking grew up in the Mahoning Valley because this area offered some special advantages. In the last century, the region was rich in those resources needed for making iron and steel: surface iron ore, high grade coal, and limestone. America's first blast furnace was built here in 1803. By the turn of the century, Youngstown and the Mahoning Valley were second only to Pittsburgh as the nation's iron and steel producing center.

Today, most of the half million people who live in the Mahoning Valley owe their livelihoods directly or indirectly to steel. There's not only Youngstown Sheet and Tube, there's U.S. Steel, there's Jones and Laughlin, and there's Republic; and there are all little iron and steel works, the fabricators, the scrap steel dealers, and all the other peripheral enterprises that exist because of the big steel mills.

Because the Mahoning Valley lives or dies by steel, the massive layoffs have this region reeling. In workingmen's taverns with names like the Open Hearth and the Steelton Cafe, the big question is, which mill will be next to go down? Already U.S. Steel has indicated that it will soon close down its seventy-five-year-old Ohio Works. Jim?

LEHRER: Nobody knows the local history of Campbell, Ohio better than Sam Myers. Sam has worked at the Campbell works for forty-four years and is an official of Steelworkers' Local 1418. He's been a lifelong resident of Campbell, seen its good days and its bad ones, like during the Great Depression. We asked him to give us a tour of the area, along with some general impressions.

> SAM MYERS: Campbell throughout its history has a remarkable background. There was a time in the past when we were referred to as the Ruhr Valley of the United States. We were essential in producing military arsenal for the Armed Forces in World War I, World War II, the Korean conflict, the Vietnam War. I think we were quite vital to the national defense of the country. We not only contributed quite a bit of steelmaking know-how, but we also contributed a large portion of the youth in the defense of this country in World War II, and also the other conflicts that followed.
>
> And going back to my youth, there are some things that I remember quite vividly. The older first generation would often look over the top of the hill to see

whether there was smoke coming out of the stacks; to him that meant prosperity, employment, it meant food on the table.

Campbell probably represented practically every ethnic group that you could think of. The church has always been an important factor in this town for all of the ethnic groups. We have the Slovak Catholic Church -- that's St. John's -- Greek Catholic Church, you've got the Russian Orthodox, and then of course you've got the other churches that have since then moved in and taken their place with them. I think that everybody really is proud of their church background in this community.

MacNEIL: The Youngstown region became a great steel center in part because of its skilled and stable work force. Generations of Central Europeans, Italians and Irish built their lives around the mills of the Mahoning Valley. Like most everyone of his generation, Big Dan Basara has spent his whole working life at the Sheet and Tube. The day we ran into him at the Union Hall, he was talking about the old days with some friends.

DAN BASARA: Years ago, during the Depression and the Roaring Twenties, the Youngstown Sheet and Tube was somethink like a college, a steel college, where the people went from here into U.S. Steel and became presidents. This is where all the steel people come from. This is their livelihood, they know this is their livelihood, this is their bread and butter; they raise their families, pay their homes off, and they know that this is their life. And now it's just like somebody that cuts your legs from underneath you. Down you go.

FIRST STEELWORKER: When we were born, our fathers went down to Youngstown Sheet and Tube, they put in our application. When we reached the age of seventeen or sixteen, we were down there.

BASARA: It was like a family affair -- the father, the son, the brother, grandsons, they were all down there.

SECOND STEELWORKER: The only thing we knew was to come right down to the ironhouse.

MacNEIL: When Julius Petko was laid off this fall, a family tradition ended. At one time he, his father, and seven brothers worked for Youngstown Sheet and Tube.

JULIUS PETKO: It used to be, years ago, when your dad was hired in the mill, and if I applied for a job, why, they'd look at my dad's record and see what type of employee he was. If he was a good worker and never missed work, why, they figured I was a good risk. Because I happened to be working near my dad or something, and if I did get in trouble, they'd go to my dad and say, Hey, straighten your son out.

WITTY: Did you enjoy your work?

BRACAGLIA: Did I enjoy my work. Are you married? My first marriage is Youngstown Sheet and Tube. I been down there when I was sixteen years old. You ask me, do I enjoy my work. I enjoyed my work so much that I used to stay an hour, an hour and a half without getting paid. That's how I enjoyed my work.

LEHRER: To find out how the layoffs are affecting the families of steelworkers, we visited the Marr family -- Jim Marr, his wife Roseann, and their five children. Jim Marr was born in Struthers where he and his family now live. Jim comes from a steel family. His father worked for Sharon Steel; four of his brothers are steelworkers and also a brother-in-law. Before being laid off in the fall, Jim had worked for Youngstown Sheet and Tube for twenty-eight years. We asked him about his family's reactions to the big layoffs.

JIM MARR: In fact, I was on vacation when I got the word that they were shutting down the hot strip, blooming mill, cold strip. At that time I was bringing my dog up to the dog pound there, and my wife and them were all crying; she says that, how was the dog when you brought him up to the dog pound? I said, well, I got a little better news for you. I says, think this one out, I don't have a job.

ROSEANN MARR: And I said, I don't care about your job, all I'm worried about is the dog. (Laughing.)

Mr. MARR: It didn't hit her.

LEHRER: With his many years of seniority, Jim could go back to work in another part of the mill. But because of union rules, he would actually lose money by returning. He is also awaiting the outcome of arbitration of Rule 65, a new steelworker pension plan under which he might be eligible for early retirement. While such matters are being resolved, Jim remains home on a sort of extended vacation.

Mrs. MARR: I really enjoy having him home because maybe I'm being a little selfish -- the painting's getting done, the drippy faucets are getting the washers put on. But I don't know how I'll feel maybe by this summer. It doesn't bother me, though, him being around the house. I know, if he's home for a long period of time, though, that it will affect him.

Mr. MARR: It bothers me to stay home complete-

> ly all day. I enjoy my eight hours of going to work, and come home and then go through my daily routines, because it seems to make the day go by faster, you know. But when you're just home mostly all day, you don't find too much to do. I'd sooner work. If I'd had to retire or something like that, I don't think I would enjoy it.

LEHRER: Financially, the Marrs say they are better off than a lot of their neighbors and friends. Although they have they expenses of sending son Jimmy away to college to study engineering, Roseann works part time in a decorating business and is also part owner of a bar. At least until Jim's benefits run out, the Marrs can meet their obligations. But the pressures are clearly taking their toll on Jim Marr; he says he's developed a neurological problem that's causing his hair to fall out. And when asked if he thinks he and his family will have to leave their lovely home, he says it's not so much if, but when.

MacNEIL: With so many people like the Marrs thinking about moving and others already gone, the economic prospects of steeltowns like Campbell are not good. We talked to a number of Campbell businessmen to see what the impact has been so far. Our first stop was City Hall, and Mayor Rocco Mico, who just took office the first of the year. We asked the new mayor how the closing of the mill will affect tax collections.

> Mayor ROCCO MICO: Just to give you a ballpark figure, we're going to lose approximately $1,240,000. And that's quite a bit of money. This is the only thing we have in Campbell, Youngstown Sheet and Tube. And when they pay sixty-five or seventy percent of your taxes, you know why our tax base is so low.
>
> WITTY: What do you think is going to happen to this town?
>
> MICO: Well, let me put it this way: we're not going to die, because we have good people here in the city of Campbell -- very good people. And I think we're just going to have to buckle down, the whole community's going to have to buckle down and just go out here and do things to show other communities that Campbell's not dead. We're not going to be a dying community.

MacNEIL: Mayor Mico is hopeful, but some danger signs are already apparent. At the Dollar Savings and Trust Company in Campbell, district manager Nick Opencar reports that loan volume is down this winter. Otherwise, business in the bank is pretty normal.

At a Spanish-American grocery that caters to Campbell's Puerto Rican community, owner Merchadi Alghamee is gloomy. He says he's going back to his native Yemen, after running the store for twenty-four years. His business is falling off, he says, and he's been robbed four times in the past year. He says he's afraid for his safety.

At Christy's Bakery, owner Christy says his weekend business is holding up but his weekdays are off. Steelmen used to come in and buy donuts by the dozen to take into the mill. His donut business is, way down since the big layoffs, says Christy.

Tom Peters owns a small general merchandise store directly across from Youngstown Sheet and Tube. He says it's already too late to sell out, so he just keeps going day by day.

> TOM PETERS: The way the business is now, even though it's dropped off, if it would maintain this pace, we're okay here, we can still make a decent living. At any other rate -- if it would slow down -- then we're in trouble.

MacNEIL: More trouble may lie ahead. A merger plan, already announced, between Lykes, the parent corporation of Youngstown Sheet and Tube, and LTV, parent of nearby Jones and Laughlin Steel, could put 1,100 more men out of work. Those figures are recently quoted by Youngstown Mayor Philip Richley. Jim?

LEHRER: One unusual aspect of the Youngstown situation has been the active role of the churches. Several weeks after the Lykes Corporation announced they were closing the mill, religious leaders of the Mahoning Valley formed an Ecumenical Coalition. Part of their plan was to see if worker-community ownership of the Campbell Works would make economic sense. Father Edward Stanton has been one of the organizers of the Ecumental Coalition and is now its staff director. We asked him how the coalition came up with the idea of worker-community ownership of a steel mill.

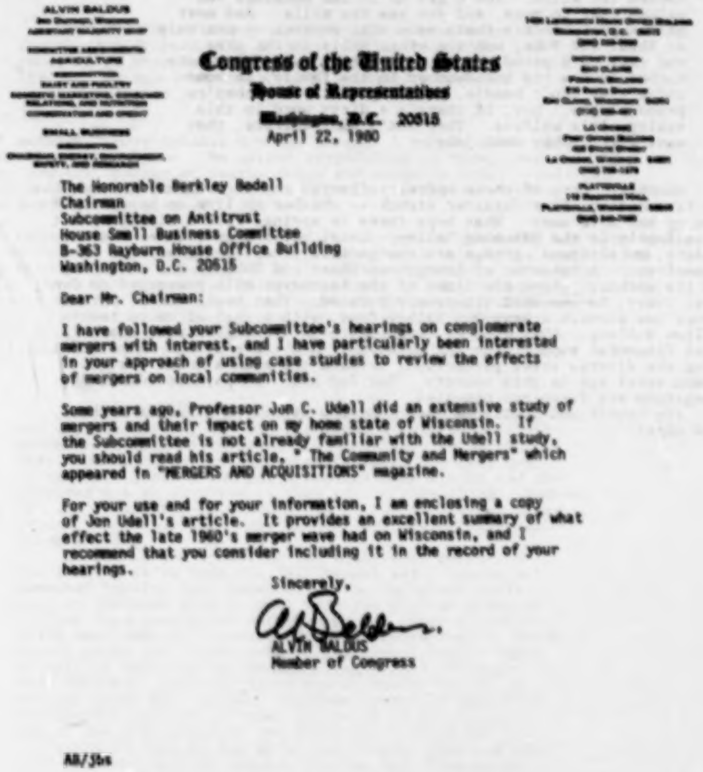
> Father EDWARD STANTON: We looked around and didn't see anybody getting off the plane out at the airport with duffel bags full of thousand dollar bills. So we said, Okay, community-worker ownership is maybe the only way we can go. There's two basic reasons that clergy and the churches are as involved as they are in this thing: number one is, pastorally we heard 5,000 of our people out there saying, We're hurting. And number two, nobody else was doing a thing.
>
> As far as the impact on the individual people, I don't think we've seen the full impact yet. People are somewhat hopeful that somebody -- the religious coalition or somebody else -- will turn the situation around. I think that people are not showing the concern, but I think deep down it's there. Eastern Mental Health, which is the group that takes care of the mental health needs of half of this county, has received a $155,000 grant from Columbus, from the State mental health bureau, a special grant for the next eighteen months, to deal with the special problems of that are going to be coming up. One of the main concerns the first day that we met as clergymen to look at the moral and ethical problems was also a social service concern that we had, because we felt there was going to be an increase in the use of alcohol, increase in the use of drugs, increase in domestic difficulties, child abuse, all of these things which could possibly happen. We don't see any great signs of them happening yet, but deep down we feel if the situation is not reversed -- because I know the peo-

> ple of this valley very well; I was born here myself, I grew up here, I worked in the mills summers when going to college in the seminary, and I had a parish on the east side of Youngstown, Sacred Heart, which overlooked the mills. You'd get up in the mornings and walked over to mass, and you saw the mills. And most of the parishioners there were mill workers -- not only at Sheet and Tube, but the other mills in the area. And they're a proud people. That role reversal, where Mother is now the breadwinner in the family, is something they can't handle. And rightfully so, they're proud people. Now, if there's a dirty word in this valley, it's welfare. They don't want welfare, they want work. They want jobs.

MacNEIL: Many of those voices reflected the uncertainty in the valley five months after disaster struck -- whether to live on hope, or to give up and move away. What hope there is springs from a rising spirit of self-help in the Mahoning Valley. Local politicians, those church leaders, and citizens' groups are energetically canvassing ways to save themselves. A takeover of Youngstown Sheet and Tube by the community and its workers, along the lines of the Kostmayer bill presented to Congress today, is the most vigorously pursued. That coalition of church groups has started a Save Our Valley fund, with a goal of up to twelve million dollars. They wish to demonstrate to Washington that there is local financial support for the takeover. And there's talk of rationalizing the diverse steel production, to make the area a model for the modern steel age in this country. But for now, the psychic wounds in Youngstown are fresh and unhealed.

Jim Lehrer and I will be back tomorrow night. I'm Robert MacNeil. Good night.

Appendix M.—Letter From Hon. Alvin Baldus; re Jon C. Udell's Study of Mergers in Wisconsin



ALVIN BALDUS

Congress of the United States
House of Representatives
Washington, D.C. 20515

April 22, 1980

The Honorable Berkley Bedell
Chairman
Subcommittee on Antitrust
House Small Business Committee
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I have followed your Subcommittee's hearings on conglomerate mergers with interest, and I have particularly been interested in your approach of using case studies to review the effects of mergers on local communities.

Some years ago, Professor Jon C. Udell did an extensive study of mergers and their impact on my home state of Wisconsin. If the Subcommittee is not already familiar with the Udell study, you should read his article, " The Community and Mergers" which appeared in "MERGERS AND ACQUISITIONS" magazine.

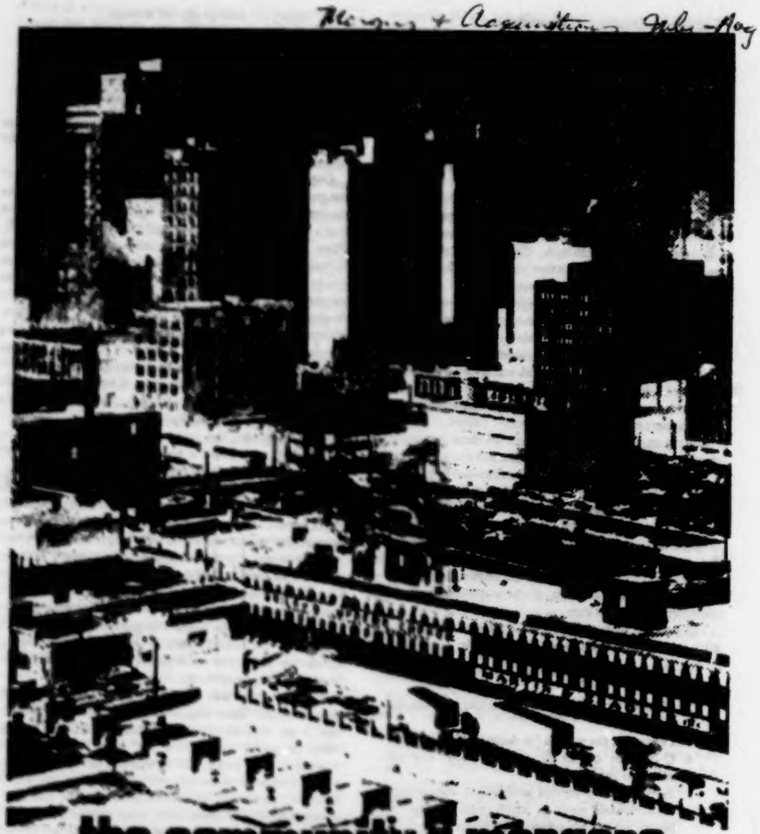
For your use and for your information, I am enclosing a copy of Jon Udell's article. It provides an excellent summary of what effect the late 1960's merger wave had on Wisconsin, and I recommend that you consider including it in the record of your hearings.

Sincerely,

ALVIN BALDUS
Member of Congress

AB/jbs

Mergers + Acquisitions July-Aug.



the community & mergers

Jon G. Udell

Social and Economic Consequences of Corporate Acquisitions on a State

The corporation, recognized by law as an individual, is a significant member of society and an important citizen in a community. Upon merger, this citizen may undergo a transformation which will have a major impact on its corporate life and society.

With the current wave of merger activity, many (if not most) states are seeing locally-owned companies acquired by firms from a handful of states such as New York, California and Texas. While the *quantitative* impact of these acquisitions is likely to vary from one state to another, the *qualitative* dimensions of research in Wisconsin may well apply to most states other than those few that house the headquarters of the active acquirers.

From a state's point of view, there are three major merger situations to be recognized. First, there is the acquisition of a local firm by an out-of-state firm—usually a larger company. Secondly, there is the merger of a local firm with another in-state company. Thirdly, there is the acquisition of an out-of-state firm by a local company. In this study, research is concentrated on the first two types of mergers. By comparing the results of in-state mergers with out-of-state mergers, one is able to obtain an estimate of the impact of the location of the acquiring firm on the communities and the state.

The possible social and economic effects of mergers on a state are varied and numerous. They include:

1. Alteration of competitive conditions and price levels.
2. Changes in the growth (or decline) of employment.
3. Changes in the growth (or decline) of payrolls.
4. Growth or decline of physical assets and construction activity.
5. Increased or decreased profitability and changes in accounting methods which influence the corporate income tax revenues of the state.
6. Post-merger movement of corporate executives in and out of the state.
7. Changes in purchasing procedures and sources of supply for both goods and services.
8. Alteration of union agreements, labor relations, and working conditions.
9. Changes in the value of shareholders' equity.
10. Alteration of the corporation's attitude toward and support of community causes.

While other possible effects could be named, these are among the most prominent and some are worthy of brief comment.

Competition and Prices. Any change in the intensity of competition and level of prices brought about by the merger of a firm could have a significant impact on the firm's customers and the economic environment of its state. There are, of course, several studies and numerous case histories of the impact of horizontal and vertical mergers on competition. There is reason to believe that conglomerate mergers also alter competitive conditions by increasing the financial strength, marketing and distribution capabilities, technological capabilities, and management of a merging company. (See p. 28, Vol. 4, No. 2 of M&A). If the company is a weak competitor made stronger, the merger is likely to benefit society. However, if an already powerful competitor is made still stronger, the result may be decreased competition and higher prices.

While important, the study of the effect of mergers on competition and prices is best done at the national level because competition usually transcends state boundaries.

Employment and Payrolls. If the acquisition of a firm results in greater capital resources, a better marketing organization, increased productivity, and an improved competitive position, the firm will expand and employment is likely to rise. On the other hand, the acquired firm may be less well managed following the merger, or the acquirer may "milk" the firm, using its resources and income to build other out-of-state or out-of-country operations of the parent company. The parent company may go so far as to shut down the acquired firm or to transfer the operations to another state. The consequence, of course, is a reduced level of employment for the state's labor force.

A merger may also affect the quality of employment opportunities. Some acquisitions by out-of-state firms result in the removal of corporate headquarters and management personnel away from the state of the acquired company. As a result, the community involved may lose talented citizens active in civic affairs. Also lost are the incomes, purchases, and taxes paid by the transferred executives. On the other hand, some acquisitions result in an increased executive staff and therefore enlarged payrolls, expenditures, tax revenues, and talent for the community and the state.

Sources of Supply. The acquisition of a firm may change its sources of goods and services. This is particularly true when the parent firm has other divisions which produce some of the materials which are purchased by the acquired firm. Even when this situation does not exist, the acquiring firm may have a central purchasing arrangement, reciprocal purchase agreements with suppliers, or it may use different

---

Jon C. Udell is assistant dean and director, Bureau of Business Research and Service, Graduate School of Business, University of Wisconsin. He prepared the special study "Social and Economic Consequences of the Merger Movement in Wisconsin."

criteria in selecting sources of supply. Also, the acquiring firm is less likely to owe allegiance or even to have the normal rapport with suppliers in the area of the acquired firm. In addition, the acquired firm may be required to use the accounting, legal, and financial services of the parent corporation. When the parent is located in another state, there may be a significant loss to business service organizations in the community and state of the acquired firm.

Stockholder's Equity. When a company is acquired through a cash transaction, there is little doubt about how the previous owners of the acquired firm have fared. However, in recent years most mergers have been accomplished by an exchange of securities or a combination of securities and cash. Those who receive securities of the acquiring corporation as compensation for their company are likely to market them gradually to postpone and reduce capital gains taxes. Therefore, the ultimate amount received for a company will depend upon the value of the acquiring company's securities over a considerable period of time.

Earnings Dilution. In most acquisitions involving stock there is dilution of the earnings of the selling stockholders because the price-earnings ratio of the buying company is higher than that of the selling company. This means that some portion of both past and future earnings of the company merging will be credited to all other stockholders of the buying company. Turned into dividends it can mean a cash outflow from the state.

Capital Outflow. When selling shareholders realize cash for their equities there can be a tendency for this cash to leave the community rather than to be reinvested to support local enterprises.

Corporate Commitment to the Community. The dedication of corporate management to community causes may be adversely affected when a locally owned and managed company is acquired by a firm in another state. On the other hand, some large corporations are socially conscious and have a policy of active involvement in community affairs at all company locations.

Employee Relations and Union Agreements. The merger of two or more corporations may have a significant impact on unionization and the labor relations policy of the firms. A merger may bring together a unionized and a nonunionized company, or firms with competing unions. In addition, the labor contracts of the two companies often differ markedly. The meshing of fringe benefits has been one of the most difficult problems arising from acquisitions. It may take years to integrate differing pension, profit sharing, and other employee benefit plans. While the impact of a merger on unionization, labor relations, and working conditions is one of the major unknowns today, it is a subject best explored at an interstate level.

State Revenues. A merger is likely to either raise or lower the efficiency, sales, and profitability of the firms involved. In addition, accounting procedures, when changed, can alter the stated profitability of a business. For example, a division's prorated share of profits in a consolidated income report will differ from those that would be shown by separate reports for each geographical unit or division of the company. If the acquiring firm is less profitable than the acquired company, the parent company is in a position to legally avoid a considerable proportion of the income taxes which the acquired company would otherwise have had to pay.

Management's perception of how their companies were changed

In this paper, we will concentrate primarily on the impact of mergers on sources of supply, employment, payrolls, and corporate giving. Prior to doing so, however, we will look at how management perceives the effect of being acquired.

Reasons for Being Acquired. Personal interviews with the chief executives of 20 acquired Wisconsin companies revealed that the two most frequent reasons for merger were "to reduce estate tax problems for the previous owners" and "to acquire greater financial sources for the company." (Ninety percent of the executives interviewed had been with the corporation prior to its acquisition.) Twenty-five percent of the respondents mentioned the estate taxes, and an additional 15 percent said the acquisition was desirable because the particular method of equity transfer employed allowed the owners of the corporation to sell the company without incurring capital gains taxes. Twenty percent of the respondents indicated that the acquisition was a way for the company to "go public" or to get on the New York Stock Exchange. One respondent mentioned the desirability of diversifying personal holdings. Only two respondents mentioned the financial gain resulting from the acquisition.

Twenty-five percent of the respondents mentioned the desirability of acquiring larger capital resources. Twenty percent stated that the diversification and expansion of product lines were major reasons for being acquired.

Two executives felt that marketing considerations had prompted the merger. In both cases they stated that the anticipated marketing advantages had not been realized. The research and development advantage anticipated by one respondent also had not been realized.

More personal reasons, such as aging management, retirement of owner, and death of owner were mentioned by one respondent each.

Impact on Management Personnel. The executives were asked if there was any increase or reduction in the number of upper management personnel located in their community as a result of the merger. Only three respondents, or 15 percent, stated that the number of management personnel had increased. Similarly, three respondents said there had been a decrease. Two of these three mergers involved the acquisition of a Wisconsin company by another Wisconsin company. (Five of the companies studied had been acquired by other Wisconsin corporations. Fifteen were acquired by firms headquartered in other states.) Obviously, it is easier to consolidate the home offices of merging corporations in close geographical proximity. Sixty-five percent of the respondents stated that there had been some movement of executives. Several respondents reported that some of the company's executives had been promoted to the home office of the acquiring company. Others mentioned that some executives had been retired early or had left for one reason or another. One respondent was unable to determine whether the number of management personnel had changed since the merger.

Location of Home Offices. Twenty percent of the acquired corporations had their home offices dissolved as a result of the merger. However, in three of these instances, Wisconsin firms had been the acquiring corporations. In fact, the acquiring corporations had been located in the same community as the acquired firm. In 80 percent of the mergers, there was no change in the location of the executive offices of the acquired firms.

Growth of the Acquired Firms. The respondents were asked if there had been any change in the rate of growth of their firms since acquisition. Thirty-five percent of the respondents stated that growth had accelerated since acquisition.

Only one executive stated that his firm's growth had declined since acquisition. Declines in growth may be understated because most respondents were in the position of being asked to state whether the growth of their company had increased or decreased since they had become president or general manager of their division of the company. Despite this possible bias, 60 percent of the respondents claimed that there had been no change in their firm's rate of growth since the merger. Given the financial advantages, mainly greater working capital for expansion, one would have expected an acceleration in the growth of the firms. In most instances, this had not occurred.

Advantages of Becoming Acquired. The executives were asked, "What advantages to the company, if any, resulted from the merger?" To aid their response, financial, marketing, production, personnel, and research and development advantages were suggested. The majority of the responses received were financially oriented. Seventy percent of the respondents indicated that greater financial resources were available to the company as a result of the acquisition. Related advantages reported were sounder financing, combined resources, increased financial strength, and more financial leverage. One respondent mentioned better financial management, two respondents said that profits had increased as a result of the merger, one indicated that the company now enjoyed greater stability. Two executives mentioned the spreading of financial risks through the pooling of the resources of the merging companies.

Few marketing advantages were reported. The most frequently mentioned benefit was better distribution, indicated by 15 percent of the respondents. Two respondents mentioned a better advertising program, and two an expanded product line.

Reports of production advantages were not prevalent. However, two respondents did mention improved technology made possible by the acquisition. Obviously, some of the firms had greater production because of the growth that occurred since the acquisition.

Some personnel and organizational advantages were mentioned. One respondent said that the company had a stronger management since the acquisition, another mentioned the value of management guidance from the parent corporation. Two respondents indicated that the company now has new and better management. One respondent reported improved employee benefits and another consolidated office procedures.

Research and development improvements of some type were mentioned by 35 percent of the respondents. However, several executives indicated that these advantages were not as great as had been anticipated at the time of merger.

A few other advantages were indicated by the executives. Twenty percent of the respondents said that the parent corporation's brain bank was a definite asset to the management of the acquired corporation. Two of the companies now have access to computers which they did not have prior to merger. Two other companies mentioned the increased possibility of overseas expansion because of their acquisition.

Disadvantages in Being Acquired. According to the respondents, there are not very many disadvantages as far as finance, marketing, production, personnel, and research and development are concerned. However, several respondents did mention managerial or organizational disadvantages. One complained of the control exercised by the parent corporation. Another respondent disliked the procedures which the company now has to use. A third resented having to use the parent company's financial institutions rather than local banks. Two respondents indicated that there was definite friction between management of the acquired and the parent company. One respondent resented the drain of local talent to the acquiring corporation.

One manager was dissatisfied because he felt his company was not being fully developed. He wanted the parent corporation to give him more money and more managerial assistance so that the potential could be realized. Still another indicated that the parent corporation did not understand the company and its problems and he resented the large amount of paper work required by the parent corporation. Two respondents disliked the loss of flexibility and freedom in making financial and purchase decisions. One executive felt that he had lost status as a result of becoming part of another corporation.

Changes in Sources of Services and Supply. According to the executives, only 25 percent of the acquired corporations use the same legal services they used prior to the mergers. In an additional 15 percent of the mergers the company was still able to use local legal services for some purposes such as labor negotiations. However, in 75 percent of the mergers, the legal services of the acquiring company were used in whole or in part.

Thirty percent of the companies still use the same financial institutions they used prior to the mergers. Seventy percent of the companies had shifted to the financial institutions of the parent corporation. Similarly, only 30 percent of the companies used the same accounting firms as were used prior to the merger. In an additional two companies, both the original accounting firm and the accounting firm of the parent corporation are being used.

Only two firms have been required to use the centralized purchasing of the parent corporation. In both instances, the acquiring corporation was another Wisconsin company. However, several respondents mentioned that some items must now be purchased through the parent corporation.

Financial Contributions to the Community. Executives were asked if there had been any increase or decrease in their company's financial contributions to the local community as a result of the merger. Forty-five percent of the executives claimed that their company's financial contribution to the community had increased. However, specific comments indicated that in six of the nine companies with increased contributions, the contribution was in the form of greater employment and larger payrolls, not increased financial contributions to community causes. Only three respondents indicated that the company now gives more to local charities and causes such as the Community Chest or United Fund. These three executives said that as a result of acquisition, their company's contributions had increased because of their greater ability to give and a greater awareness of social responsibility.

Twenty percent of the respondents said that their financial contributions to the community had decreased. These respondents complained that their corporate giving had been taken over by central management or that the management of the parent corporation was not community-minded.

The remaining 45 percent of the executives claimed that there had been no change in their company's contributions.

Summary. The major reasons which prompted the companies to be acquired were predominantly financially oriented. The reduction of estate tax problems and the provision of greater capital were mentioned most frequently. In addition, the ability to sell the original company without immediate capital gains taxation and other financial advantages were frequently mentioned. Most of those who had merged for nonfinancial considerations indicated that the anticipated advantages had not been realized.

The companies had not experienced great changes in management personnel as a result of the merger. It is significant that 90 percent of the executives interviewed were with the corporation prior to its acquisition. Eighty percent of the companies continue to operate the home offices which existed prior to the acquisition.

Most of the companies experienced no change in growth since the acquisition. Given this finding, one can question the validity of corporate financial advantages associated with a merger. If the existence of additional sources of financing does not accelerate the growth of the acquired corporation, there is little advantage to having additional capital available.

Despite the fact that most acquired companies experienced little or no additional growth, the financial advantages of merging were mentioned more often than any others. A few of the executives were also able to name marketing benefits and some improvement in the company's research and development program. Production and personnel advantages were infrequently mentioned.

The disadvantages resulting from the mergers were primarily organizational in nature. They included friction between the acquired and the acquiring companys' managements.

Changes in sources of supply may represent the greatest loss to a state's economy when a local company is acquired by an out-of-state firm. Most of the acquired companies participating in the survey now use the financial institutions, legal services, and accounting services of their parent companies. Apparently, suppliers of services rather than suppliers of goods, are more likely to lose clients when their customers are acquired by larger firms.

Commitment to the community

When a local firm is acquired by an out-of-state corporation, the new owners may feel little commitment to the local community. A low level of interest is likely to be reflected in the acquired firm's corporate giving to charitable causes. In one community an official reported, "Because of this merger, there is now little or no availability of executive talent (from the acquired company) to staff civic and local projects. Apparently fiscal problems in the parent firm developed after the acquisition. Local budget cutbacks seem to be the order of the day." On the other hand, large corporations are aware of the importance of their public image and social-consciousness can be an important factor of corporate strategy for both altruistic and selfish reasons. In commenting on another merger, the same community leader gave this report: "The previous ownership, although local, was not enlightened and participation in civic affairs was limited. Present management participates widely in local affairs and gives fair-to-excellent support for civic operating and capital fund drives."

Another factor of substantial import is the prosperity and growth of the firm following merger. In those instances where acquisition leads to the eventual demise of the firm, corporate giving ceases. On the other hand, should the merger greatly increase the growth and profitability of the acquired company, corporate giving may rise substantially.

With the cooperation of the United Fund and Red Cross of Milwaukee, information on corporate contributions was collected with the promise that data pertaining to individual firms would be kept confidential.

Two samples were selected. The first was composed of 30 Milwaukee companies which have been acquired by out-of-state corporations since 1958. The second sample consists of 30 non-acquired Milwaukee corporations from similar industries and of about the same size as the acquired companies. This sample is for control purposes and provides a basis for estimating what would have happened to the contributions of the acquired companies had they not merged.

Six of the acquired companies were merged during the period 1959 through 1963. Their contributions since merger compared favorably to the contributions of the non-acquired corporations. In contrast, the aggregate contributions of the 24 companies acquired in the 1964 through 1968 period have declined since their acquisition by out-of-state firms.

The total 1958 to 1968 rise of United Fund contributions of the 30 acquired companies was less than half as large as the increase of the non-acquired companies. Contributions of the acquired companies rose 16 percent during ten years, while those of the non-acquired corporations rose 34 percent.

Interestingly, the six firms acquired before 1963 enjoyed a substantial growth of employment. While their total corporate contributions have risen, the average corporate contribution per employee has declined. In contrast, the 24 firms acquired since 1964 have seen their aggregate employment decline. While their contributions have also declined, the average contribution per employee has risen slightly.

Comparing 1958 to 1968, the 30 non-acquired firms have, in aggregate, enjoyed a greater growth of employment than the acquired firms. Their contributions have risen more than twice as much as the acquired firms', and their contributions per employee have risen more rapidly than those of the acquired firms'. The major conclusion to be derived is that United Fund and Red Cross contributions in Milwaukee apparently have been adversely affected by corporate mergers with out-of-state firms because of decreased rates of growth among most of the acquired companies. However, this conclusion applies to the aggregate experience of the 30 acquired corporations. It should be emphasized that a number of these corporations have grown substantially since their acquisition and most of the acquired corporations have increased their contributions. Unfortunately, those that decreased the size of their gift tended to decrease it substantially.

We asked the United Fund personnel and their associates to evaluate the pre-and post-merger participation of the executives of acquired companies in community affairs. According to their evaluation, there has been a major increase in the amount of volunteer leadership by executives in one of the 30 companies. There was a slight increase on the part of executives in a second company. In 16, or 53 percent, of the acquired companies, there was no perceivable change in the participation of management personnel in the United Fund and Community Services program. There was a slight decrease among the executives of four companies, and a major decrease among the managers of eight companies. Therefore, the overall effect of the acquisitions was a decrease in the personal commitment of executives to the United Fund and Community Services program of Milwaukee.

Employment and payroll growth

Potentially one of the most significant social and economic consequences of the merger movement is its impact on employment and payrolls.

When a local firm is acquired by another local corporation, the management of the firm and its operations are likely to remain in the state. However, an acquisition by an out-of-state corporation removes the ownership and ultimate control from the state. In turn, this *may* lead to the transfer of executives, corporate offices, and even plants from the state. For this reason, two sub-samples were developed—one consisting of Wisconsin businesses that have been acquired by out-of-state corporations, the other consisting of Wisconsin companies acquired by other Wisconsin firms. The former type of acquisition will be referred to as an out-of-state merger, the latter as an in-state merger.

Nature of the Sample. The 227 Wisconsin companies included in the analysis were acquired during the five years 1963-1967. Thirty-seven percent of the sample firms were acquired by out-of-state corporations, 63 percent by companies in Wisconsin. As these statistics indicate, most Wisconsin firms that are acqquired are merged with other Wisconsin corporations. However, the proportion of in-state mergers declines with the size of the acquired Wisconsin corporation. Apparently most of Wisconsin's larger corporations entering mergers are being acquired by out-of-state conglomerates such as W.R. Grace and Litton Industries.

Two-thirds of the acquired companies were manufacturers; the remaining were retail and wholesale establishments, service businesses, and firms involved in the transportation, communication, and utility industries.

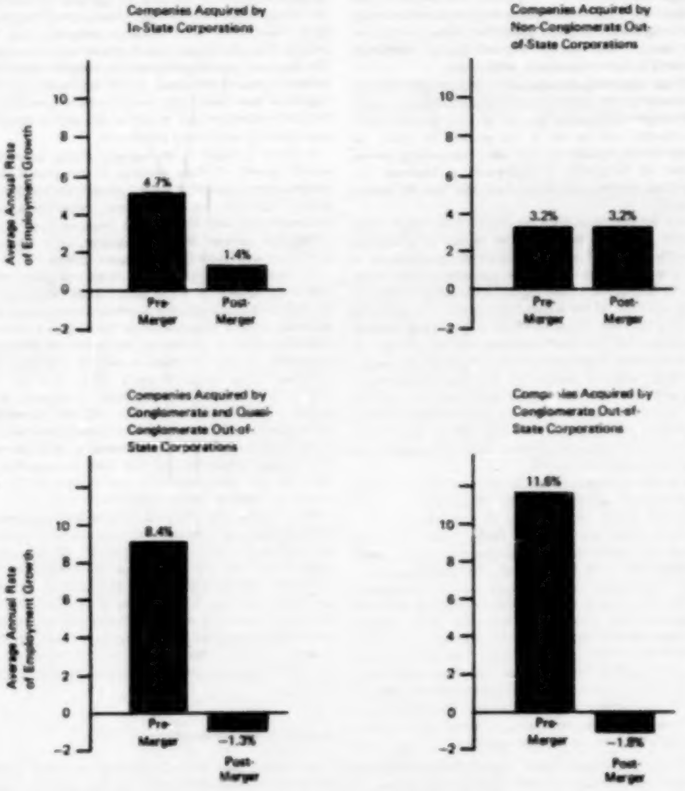
Pre- and Post-Merger Employment Growth. Using 1960 through December of the year preceding the merger as the pre-merger period, and the year of merger through 1968 as the post-merger period, slightly less than half (49 percent) of the acquired companies had an increased rate of employment growth following their acquisition. If the year of merger is used as the dividing line between the pre- and post-merger periods, only 45 percent of the companies had an increased rate of employment growth after acquisition. Both in-state and out-of-state mergers had more declines than advances in employment growth during the post-merger period. Also, there tended to be an inverse relationship between post-merger growth and the size of the acquired companies. In other words, the larger the company, the greater the likelihood of decreased growth following acquisition.

The aggregate employment of the acquired firms offers the best measure of the overall impact of acquisitions on employment. The average annual pre-merger employment growth rate of the companies acquired by in-state corporations was 4.7 percent. Following the mergers, their growth rate declined to 1.4 percent—considerably less than in the pre-merger period. (Pre-merger period is 1960 through December of the year preceding the merger. Post-merger period is year of merger through 1968.)

The adverse impact on Wisconsin employment among the firms acquired by out-of-state corporations was substantially greater than among those acquired by Wisconsin corporations. However, an interesting picture emerges when the acquired companies are classified according to type of merger—conglomerate or non-conglomerate. As shown in Figure 1, Wisconsin companies acquired by out-of-state

Figure I

PRE– AND POST–MERGER EMPLOYMENT GROWTH
OF ACQUIRED COMPANIES IN WISCONSIN*



*Pre-merger period is 1960 through the year preceding merger. Post-merger period is the year of merger through 1968.

non-conglomerates had a pre-merger and post-merger employment growth of 3.2 percent. Among the firms acquired by conglomerates such as Litton Industries, Tenneco Corporation, "Automatic" Sprinkler, and [illegible] Paints, and quasi-conglomerates, such as Beatrice Foods, FMC Corporation, and Consolidated Foods, the pre-merger employment growth rate was 8.4 percent and the post-merger rate was minus 1.3 percent. One reason for the decline was a substantial reduction in employment among the conglomerate-acquired companies during the year of the merger. This usually was not true of companies acquired by non-conglomerate corporations.

If the quasi-conglomerates are excluded from the conglomerate growth calculations, we obtain an average annual pre-merger employment growth of 11.6 percent and a post-merger rate of minus 1.8 percent. In short, the conglomerate acquisitions have had a substantially adverse impact on the growth of employment in Wisconsin. The non-conglomerate acquisitions have not had an adverse impact.

It is difficult to evaluate the decline in the employment growth rate. The decrease could be due to efficiencies brought about by the mergers, the transfer of employees to the acquiring company, or slower corporate growth following the acquisition. In this regard, and based on a survey of only a portion of the acquired companies, it is interesting to note that only one-third of the employees of acquired companies felt that their employer was any stronger or their company better managed as a result of the merger. Similarly, only 35 percent of the chief executives of acquired companies felt that the acquisition had increased the growth of their corporation. These findings and the declines in employment growth rates tend to discredit the contention that being acquired is likely to strengthen the firm and accelerate its growth.

It should be recognized that the adverse finding regarding employment growth among conglomerate-acquired companies cannot be applied to all acquisitions by conglomerate firms. As shown in Table 1, nine of the 24 companies merging with conglomerates and quasi-conglomerates in the 1963 through 1967 period enjoyed a higher post-merger than pre-merger rate of employment growth. Even among the companies acquired by the same conglomerate, post-merger experience varied widely. However, the fact remains that the majority of the firms acquired by conglomerates and quasi-conglomerates were rapidly expanding businesses and, since their acquisition, the majority of these firms have experienced substantially reduced employment growth or a decline of employment in Wisconsin. This occurred during a period of a rapidly growing employment in the state as a whole.

Pre- and Post-Merger Payroll Growth. Because of rising inflation and the rapid growth of wages and salaries in recent years, one would expect that the growth of payrolls to greatly exceed that of employment. This should be especially true in the post-merger period because of the rapid inflation of 1967 and 1968.

Despite this expectation, the number of advances and declines in payroll growth were about equal among the 227 companies acquired during the 1963-1967 period. Forty-seven percent of the companies experienced an increased rate of payroll growth during the post-merger period, and 53 percent had a decreased rate of payroll growth.

The best measure of the apparent impact of acquisitions on payroll growth is provided by aggregate information. The average aggregate pre-merger growth rate of Wisconsin firms acquired by other Wisconsin companies was 9.2 percent. The post-merger payroll growth was 6.5 percent. This decline in payroll growth was not nearly as large as the decline in their employment growth rate, indicating that employees have fared fairly well since the acquisitions. In fact, the post-merger payroll growth rate was 4.6 times the corresponding employment growth rate.

As shown in Figure II, the aggregate average pre-merger payroll growth of firms acquired by out-of-state non-conglomerate corporations was 9.2 percent; the post-merger payroll growth was 6.3 percent. Interestingly, the pre-merger rate was almost three times as great as the employment increase of these companies, while the post-merger rate was double the employment increase.

The fact that this has occurred in spite of greater wage and salary increases in recent years indicates that some of the higher salaried employees may have been transferred to other locations or eliminated from the corporate payrolls. This observation is corroborated by surveys of newspaper executives, chamber of commerce officials, and corporate officers. (The total research effort included five surveys—the general public, employees of acquired companies, chamber of commerce officials, newspaper executives, and chief executives of acquired companies.) In about 20 percent of the mergers covered by these surveys, the acquired companies had lost their headquarters in Wisconsin and still others had seen a reduction in the number of corporate officers located in the state.

The pre-merger payroll growth of those firms acquired by conglomerates and quasi-conglomerates was 11.5 percent; the post-merger rate was 2.8 percent. If the quasi-conglomerates are eliminated from the calculation, the pre-merger growth rate rises to 15.6 percent, and the post-merger rate falls to 2.1 percent. In short, acquisitions by conglomerates have adversely affected both the employment and payroll growth of the acquired firms. This has occurred in spite of the fact that ten of 24 firms had an accelerated payroll growth following their acquisition. (See Table I).

Summary and recommendations

It is apparent that Wisconsin's economy has fared better among those companies acquired by Wisconsin firms than among those acquired by out-of-state corporations. However, the negative impact of acquisitions by out-of-state corporations has been primarily centered among the conglomerate acquirers and even in this group approxinearly 40 percent of the acquired firms (in terms of employment and payrolls) have advanced more rapidly than in the pre-merger period.

Given the post-merger declines among 60 percent of these firms acquired by conglomerates and quasi-conglomerates and several interviews with merger specialists, a picture emerges. Some conglomerate corporations have sought to enhance their earnings and thus the market value of their securities by acquiring corporations at a lower price/earnings ratio than their own. Since this dilution of selling shareholders' earnings is passed out as increased earnings/per/share to all shareholders it has a tendency to increase the price/earnings ratio of the conglomerate acquirer and the conglomerate may find it easier to acquire additional firms, rather than to further develop the firm which contributed the "earnings kicker." (At the same time the firm is often bled of unused cash in order to make further acquisitions.)

While perfectly legal, such "pyramiding" activity could, in the long run, lead to the creation of financial monstrosities rather than sound and growing companies in an expanding economy. In the long run, the firm that continually seeks to expand its earnings and price/earnings ratio through acquisition and the bleeding off of financial resources in order to finance the acquisition of other companies, may wind up in serious difficulties. If, in addition, the conglomerate were to rely on financial gimmickry to provide capital resources, it may become too thinly financed (too heavily leveraged) to weather any period of general economic weakness. The incidence of a

Table I

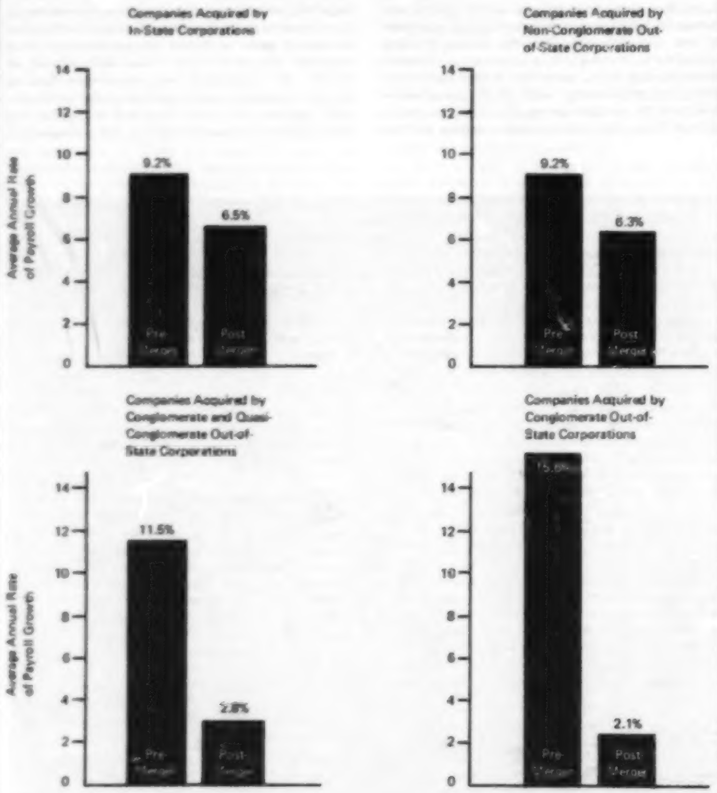
PRE– AND POST–MERGER EMPLOYMENT AND PAYROLL GROWTH RATES
OF 24 FIRMS ACQUIRED BY CONGLOMERATES

Firm No.	Pre-merger Employment	Post-merger Employment	Pre-merger Payroll	Post-merger Payroll
1	-1.98%	-1.05%	3.72%	0.70%
2A	3.85	4.88	5.82	3.34
2B	4.90	13.99	2.87	18.00
3A	4.10	27.17	8.86	-7.20
3B	-0.86	-6.60	10.30	-0.72
3C	3.28	-1.37	5.01	9.90
4A	3.91	10.41	4.86	14.40
4B	13.23	5.85	19.00	2.24
4C	4.88	20.37	8.94	22.35
4D	63.04	-12.00	78.07	79.46
4E	0.20	6.24	6.00	12.82
5	1.44	10.32	4.10	9.90
6	15.51	30.00	22.40	40.51
7	10.88	37.88	14.04	38.88
8	21.72	-12.83	27.23	-0.51
9A	5.85	5.74	6.40	10.84
9B	90.00	70.63	94.78	26.27
9C	60.18	18.64	51.80	20.20
10	1.23	-0.15	2.88	-0.40
11	7.22	0.00	2.29	0.70
12	16.94	41.80	11.87	30.30
13	24.84	Out of Business	10.04	Out of Business
14	-1.34	3.00	4.40	1.74
15	20.37	Out of Business	20.44	Out of Business

Alphabetic sequencing denotes acquisitions by the same acquiring company. Acquiring firms 1-5 are conglomerates; firms 6-15 are quasi-conglomerates.

Figure II

PRE– AND POST–MERGER PAYROLL GROWTH
OF ACQUIRED COMPANIES IN WISCONSIN*



*Pre-merger period is 1960 through the year preceding merger. Post-merger period is the year of merger through 1968.

substantial number of such recession-sensitive organizations, because of the interdependence among companies and industries, could easily weaken the total economic system. This danger could be greater than the possible adverse effects of the conglomerate movement on competition and price structure of American industry.

In emphasizing the dangers involved, we are not accusing all, or even most, conglomerates of socially undesirable financial and management practices. As already mentioned, approximately 40 percent of the companies acquired by conglomerates have enjoyed expanded employment and payrolls in Wisconsin since their acquisition. Certainly these firms are not being exploited to finance other acquisitions. Our only contention is that there are socially desirable and socially undesirable mergers, whether they be conglomerate or otherwise. Just as government policy has attempted to prevent horizontal and vertical mergers with potentially undesirable consequences, we should also attempt to prevent conglomerate mergers and related financial practices which are likely to be undesirable. General anti-conglomerate merger legislation is *not* appropriate, because it would prevent beneficial acquisitions. However, federal legislation to preclude the undesirable financial practices of some acquirers is probably needed.

At the local level, several steps can probably be taken to prevent undesirable mergers and to promote local economic development:

1. *Greater emphasis should be placed on pre-merger investigations by those who are contemplating a merger.* Many companies, especially acquired firms, have merged without adequately considering all alternatives and without sufficient knowledge of what the merger entails. Post-merger evaluation seems often to be more intensive than pre-merger. Just the opposite should be true. *Better and more extensive pre-merger investigations would increase the probability [illegible] and reduce the number of undesirable mergers. Consequently, both private industry and society would benefit.*
2. *Industry should be encouraged to consider the likely future growth of the company and other potential social and economic consequences when evaluating a merger proposal.* While personal economic considerations are bound to be major in any merger decision, management and owners should also consider the future welfare of their employees and the community.
3. *Suppliers, and particularly the service industries, should be especially alert to preserving their relationships with existing clients.* For example, financial institutions might make a concerted effort to increase the supply of capital available to local industry, thus reducing one incentive for entering a merger. *When an acquisition does occur, the suppliers of the acquired company should establish rapport with the parent company and effectively communicate information relating to the value of their services.* In so doing, some suppliers will be able to obtain additional accounts, rather than losing an existing account.
4. *States (and the federal government) might consider legislation to reduce the estate tax incentive for mergers.* Estate taxes are considerable, and privately held businesses are sometimes sold because the financial security of the heirs would be endangered on the death of the owner. Perhaps estate taxes could be spread over a period of years, thus reducing the likelihood of forced sales in order to pay estate taxes.

The merger movement is likely to continue, but perhaps at a slower pace because of increasing governmental concern and a more cautious evaluation of conglomerates and mergers by investors. This study, and other reports, indicate that a substantial proportion of the mergers during the 1960's may not have been particularly fruitful from either a public or private point of view. Hopefully, both society and industry will benefit from more prudent merger management in the decade ahead. ■

CORPORATE GIVI'G TO MILWAUKEE UNITED FUND
BY ACQUIRED AND NON–ACQUIRED COMPANIES

	6 Acquired Firms	24 Acquired Firms	30 Acquired Firms	30 Non-Acquired Firms
Indices of Total Giving:				
1958	100.0	100.0	100.0	100.0
1963	119.9	112.0	113.5	127.3
1968	138.7	110.3	115.6	133.8
Indices of Contributions per Employee, Weighted:				
1958	100.0	100.0	100.0	100.0
1963	125.8	111.8	114.5	126.3
1968	108.8	116.8	112.5	120.7
Indices of Employment:				
1958	100.0	100.0	100.0	100.0
1963	95.5	100.2	99.0	101.8
1968	127.6	94.6	102.7	110.9

best copy available

CORPORATE GIVING TO MILWAUKEE UNITED FUND BY COMPANIES ACQUIRED BY OUT–OF–STATE CORPORATIONS, 1958–1968

	1958	1963	1968
Six Firms, Acquired 1959–1963			
Total Gift	$32,772	$39,300	$45,451
Average Gift	5,462	6,550	7,575
Total Employment	3,849	3,676	4,910
Average Employment	642	613	818
Average Gift per Employee, Unweighted	$ 13.56	$ 18.34	$ 11.53
Average Gift per Employee, Weighted	8.51	10.69	9.26
Twenty-four Firms, Acquired 1964–1968			
Total Gift	$143,507	$160,750	$158,328
Average Gift	5,979	6,697	6,597
Total Employment	11,683	11,707	11,045
Average Employment	487	488	460
Average Gift per Employee, Unweighted	$ 8.43	$ 10.69	$ 8.55
Average Gift per Employee, Weighted	12.28	13.73	14.34
Thirty Firms, Acquired 1959–1968			
Total Gift	$176,279	$200,050	$203,779
Average Gift	5,875	6,668	6,792
Total Employment	15,532	15,383	15,955
Average Employment	518	513	532
Average Gift per Employee, Unweighted	$ 9.46	$ 12.25	$ 9.15
Average Gift per Employee, Weighted	11.35	13.00	12.77

CORPORATE GIVING TO MILWAUKEE UNITED FUND BY NON–ACQUIRED COMPANIES, 1958–1968

	1958	1963	1968
Thirty Firms, Non-Acquired			
Total Gift	$263,726	$335,745	$352,934
Average Gift	8,791	11,192	11,764
Total Employment	18,109	18,430	20,074
Average Employment	603	614	669
Average Gift per Employee, Unweighted	$ 8.91	$ 11.51	$ 11.32
Average Gift per Employee, Weighted	14.56	18.25	17.58

APPENDIX N.—ADDITIONAL MATERIAL SUPPLIED BY THE FTC; RE CONGLOMERATE MERGERS

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

BUREAU OF COMPETITION

February 15, 1980

Honorable Berkley Bedell, Chairman
Subcommittee on Antitrust and Restraint of
Trade Activities Affecting Small Businesses
House Committee on Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Once again, I express my appreciation for the opportunity to testify before your Subcommittee on February 7, 1980. Your Subcommittee is addressing issues which are among the more complex, but most important, issues faced today by advocates of the American competitive system.

During the colloquy that followed my direct testimony, it became clear that the Subcommittee would be interested in additional information on several subjects that were discussed. In response to your request for views on possible legislative proposals to limit conglomerate mergers, I enclose copies of (1) testimony presented by Michael Pertschuk, Chairman of the Federal Trade Commission, before the Senate Committee on the Judiciary on the Merger Act of 1979, on March 8, 1979; (2) my statement on the Merger Act of 1979, presented to the Senate Committee on the Judiciary on March 8, 1979; (3) a Statement on Conglomerate Merger Policy presented by William S. Comanor, Director of the FTC's Bureau of Economics, to the Senate Committee on the Judiciary on March 8, 1979; and (4) a public statement of the FTC on Conglomerate Merger Legislation Proposals, including a separate statement by Commissioner David Clanton. With respect to my views on government's opportunities to ease the burdens imposed upon smaller businesses, in order to encourage their independent growth and, hopefully, to provide meaningful alternatives to some mergers, I enclose a copy of my January 24, 1980 remarks before the Antitrust Committee of the Chicago Bar Association, "Small Business: A Critical Element of the American Economy." In response to your concern respecting plant closings, I enclose (1) a statement I prepared which sets forth a number of pertinent facts in the matter involving Lancaster Colony Corporation's acquisition of Federal Glass Company, and (2) a July 19, 1979 Statement of Daniel C. Schwartz, then Deputy Director of the Bureau of Competition, presented to the Subcommittee on Antitrust, Monopoly, and Business Rights of the Senate Committee on the Judiciary on the subject of "Merger Enforcement and the Failing Company Defense." Mr. Schwartz's Statement analyzes both the Lancaster

Colony matter and the American Safety Razor/BIC matter discussed in my recent testimony before your Subcommittee.*

I hope that you find these materials informative. If my staff and I can be of further assistance to your Subcommittee in these matters, please do not hesitate to call on us.

Sincerely,

Alfred F. Dougherty, Jr.
Director
Bureau of Competition

Enclosures

*Committee note: The statements of Mr. Pertschuk, Mr. Dougherty, Mr. Comanor, and Mr. Schwartz can be found in the hearing record of the Senate Committee on the Judiciary, Subcommittee on Antitrust, Monopoly and Business Rights, on S. 600, 96th Congress.

---

* I should note that Mr. Schwartz' statement contains the same unfortunate error with regard to BIC's market share as contained in my testimony. I would like to correct that error in my testimony by indicating that BIC's market share in 1976 should have been listed as 2.4% (rather than the 23% figure given on page 14 of my statement.)

EXHIBIT 1.—STATEMENT OF THE FTC ON CONGLOMERATE MERGER LEGISLATION PROPOSALS

The Federal Trade Commission views with concern the increasing number of large conglomerate mergers. We believe that the substantial and unrestricted growth of the largest firms by conglomerate merger poses significant political, social and economic risks but does not provide compensating benefits to the economy or society as a whole. Accordingly, we urge Congress to enact limited and responsible legislation to curb the growth of the nation's largest firms through conglomerate merger.

The current pace of large merger activity is disturbing. The number of $100 million or larger acquisitions that took place in 1978 was twice that of 1977. The total value of the $100 million or larger acquisitions in 1978 was approximately the same as the aggregate value of all acquisitions of all sizes reported just one year earlier. Although aggregate concentration has not increased and may have decreased slightly during 1958-1975, a continuation of the recent merger pace is likely both to increase significantly the size of many already large firms and to maintain, or perhaps increase, the already high level of aggregate concentration in this country.

In this context, further unlimited growth of the largest firms through conglomerate merger raises serious political, social and economic concerns. One concern is that such growth eliminates significant independent decision-makers and combines the economic decision-making power of the merged entities into a single unit. Another concern is that the wave of large acquisitions may tend to concentrate the political power of the business sector in a relatively small group of firms.

These concerns with large firm growth through conglomerate merger are hardly novel. As a society, we have traditionally depended on diversity of decision-making units as a basic check on the possible adverse consequences of aggregating economic and political power in the hands of relatively few. We believe not only that a balanced, efficient, responsive economic system depends on competition among individual firms in particular and related markets, but also that a relatively wide dispersion of discretionary power among independent business entities is of vital importance.

Although these concepts are central to our antitrust laws, many conglomerate mergers among large firms can be reached under current interpretations of these laws only with great difficulty, if at all, since such mergers often do not have demonstrable anticompetitive effects in particular markets. In our view, therefore, the recent striking increase in the number of these acquisitions requires Congressional intervention.

Such intervention should not be delayed because the precise magnitudes of the risks involved have not been determined. Because of their nature, many of the political, social and economic risks involved will never be quantified, yet there is ample basis for believing that these risks are substantial. In addition, as discussed below, the economic costs of limited and responsible legislation should be relatively small. Furthermore, our experience with merger enforcement has taught us that it is almost always easier and cheaper to prevent a merger before it is consummated than to separate or unscramble the merged companies. Accordingly, we believe that prompt legislative action is appropriate.

Any legislation must recognize, however, that not all large conglomerate acquisitions are harmful to the economy or society as a whole. Some of the transactions undoubtedly confer real efficiencies on the resulting firm; others will enhance competition in specific markets. The threat of takeover can constitute a significant disciplinary force for poorly performing managements. Acquisitions can also provide substantial monetary benefits to shareholders of the acquired companies.

On the other hand, these advantages are not universal and can frequently be attained through other means. A number of acquisitions by very large companies may be motivated in part by a desire for growth for its own sake. In addition, there is ample evidence that, on average, large conglomerate acquisitions do not confer significant economic benefits and that large conglomerate firms that have resulted from many diverse acquisitions are on average no more efficient or profitable than other firms. In particular, there is no evidence that these firms, or other very large firms, account for proportionately more innovation than smaller firms.

In light of this evidence, the public policy goal should be to reduce or eliminate the political, social and economic risks of large firm growth through conglomerate merger without unduly inhibiting mergers that may be beneficial. A number of proposals have been offered. One suggestion would impose an absolute prohibition on the largest transactions and would ban certain others unless the proponents could demonstrate that substantial benefits would result. Commission staff has proposed another approach, one which would permit large companies to make large acquisitions of their choice (subject, of course, to the strictures of present antitrust law), provided that they divest, within a specified period, one or more viable business entities of aggregate value comparable to that of the acquired firm.

The major advantage of the Commission staff's "cap and spin-off" proposal is that it would limit the growth of large firms by merger, without removing those firms from the acquisition market. Large firms wishing to make large acquisitions not otherwise prohibited by current antitrust law could continue to do so, subject only to the obligation to sell or spin off businesses of comparable value. Moreover, where significant efficiencies can be obtained by merger, this procedure offers even the largest firms the opportunity to take advantage of them. The Commission staff's proposal may also stimulate internal expansion by large firms, either in their existing markets or into new ones. Such expansion can be procompetitive and in some instances may also yield more productive, job-creating investment than comparable growth through large conglomerate merger. On the other hand, there are several issues relating to the implementation of the proposal which should be fully explored during legislative hearings.

Although we do not endorse any particular proposal, we do believe that the benefits to be derived by curtailing the growth of large firms through conglomerate merger outweigh the costs of preventing such growth through limited and responsible measures. Accordingly, we urge Congress to enact legislation which will accomplish that purpose.

Statement of Commissioner Clanton

I share the Commission's concern about the recent surge in large conglomerate mergers, but the complexity of the issues in my view cautions against a precipitate and overbroad response.

There is no doubt that the merger pace has dramatically quickened in recent years. Acquisitions valued in the hundreds of millions, even billions, of dollars are no longer a rare occurrence. Simply because of their size and frequency these mergers deserve searching public scrutiny. Yet, the effects of these colossal corporate combinations are hard to measure, since traditional antitrust concepts are not very helpful. In fact, little evidence exists to show that pure conglomerate acquisitions have impaired competition in specific markets. Rather, the fear is that the current merger trend, if left unchecked, will concentrate in the hands of relatively few corporate managers disproportionate influence over both private and public decisionmaking.

Notwithstanding sharply divergent views about the pros and cons of conglomerate takeovers, it seems fair to say that too much concentration of private economic resources can have undesirable consequences. The central issues, of course, are whether industrial concentration has reached critical dimensions and whether the present merger boom will significantly aggravate the situation.

By one measure, the share of assets held by the 50 largest nonfinancial corporations stood at a little over 23% in 1975; for the 450 largest corporations, the combined share was approximately 50%. These shares have not changed much over time, even with the merger wave of the 1960s. In fact, from 1958 to 1975, aggregate concentration levels of the top 50 and top 100 firms decreased slightly. That is not to say, however, that all is well and there is no need for concern. For one thing, it can be argued, with some support, that merger activity over time has precluded even further reductions in concentration. For another, the current merger round is even more intense than its predecessor and shows no signs of abating.

Still, there is much to learn about the causes and effects of concentration in general and conglomerate mergers in particular. What are the roots of the current merger explosion? Apart from general economic conditions, which undoubtedly provide a partial explanation, why are many large firms pouring their excess cash reserves into acquisitions rather than other forms of investment, such as internal expansion or de novo entry into new fields? What, for example, is the impact of government tax and regulatory policies on these investment decisions? What is the significance of other factors, such as foreign competition? Is the merger propensity limited primarily to firms in particular industries such as energy? If so, what are the reasons? Without a clear understanding of the market forces at work, efforts to divert investment capital into more socially desirable channels could come at the expense of some efficiency.

Nevertheless, given existing levels of concentration and the current merger trend, prolonged delay in resolving these issues might allow consummation of too many potentially harmful acquisitions. I believe, however, that if any additional merger restrictions based on size are imposed at this time, they should be carefully limited both in time and in scope. Thus, I would suggest that acquisition restraints be imposed only on very large firms, such as the 50 largest nonfinancial corporations. As noted above, the top 50 firms control nearly one fourth of all nonfinancial assets. Moreover, while many smaller firms are hardly corporate pygmies, the asset size disparity is most pronounced at the upper end of the spectrum.

It also seems desirable to sunset any restrictions after a limited period of time, for example, five years. That is appropriate not only because merger activity tends to be cyclical in nature but because that time frame should allow ample opportunity to review both the effects of the restrictions and the broader implications of conglomerate mergers.

In short, I agree with the Commission that the present merger phenomenon is troublesome. However, until we acquire a fuller understanding of the underlying issues, any new merger restrictions should be narrowly crafted and of temporary duration.

EXHIBIT 2.—MR. ALFRED DOUGHERTY'S REMARKS ABOUT SMALL BUSINESS IN THE AMERICAN ECONOMY

THESE REMARKS REPRESENT THE VIEWS OF A MEMBER OF THE STAFF OF THE FEDERAL TRADE COMMISSION. THEY DO NOT NECESSARILY REPRESENT THE VIEWS OF THE COMMISSION OR ANY INDIVIDUAL COMMISSIONER.

Small Business: A Critical Element Of The American Economy

Remarks of

Alfred F. Dougherty, Jr.
Director
Bureau of Competition
Federal Trade Commission

Before the
Antitrust Committee
Chicago Bar Association
Chicago, Illinois

January 24, 1980

Small Business: A Critical Element of the American Economy [1]

A subject receiving increasing emphasis in Washington is the role and significance of small business in the American economy. Just this week, the President's White House Conference on Small Business concluded its proceedings. The Conference focused on the problems faced by small business today -- especially those caused by Government -- and various remedial proposals offered by representatives of the small business community. I believe that many of these proposals will find strong support in the Administration and Congress, and will become an "agenda" for action in the 1980's.

The concerns of small business expressed at the White House Conference are well-founded: Small business appears to be in greater trouble today than ever before. In order to understand the problem, it is necessary to review the role of small business in the American economy.

There are over thirteen million small businesses in the United States. These businesses comprise 90% of all corporations. They produce 43% of our Gross National Product (over $670 billion), and provide 55% of the Nation's jobs.

---

[1] These remarks represent the views of a member of the staff of the Federal Trade Commission. They do not necessarily represent the views of the Commission or any individual Commissioner.

Moreover, between 1969 and 1976, small business created almost two-thirds of all new jobs in the national economy. [2].

In addition, small businesses, particularly those in advanced technological fields, appear to be the "cutting edge" of American industrial innovation. Small business created a preponderance of the major industrial innovations between 1953 and 1973 [3], and, through the development of new products and processes, created important new markets. The growth of these markets has far outstripped that of the "mature" markets served by large, established firms. [4] This should not be surprising. Small business appears disproportionately to harbor the true entrepreneurs in American society; the imaginative, aggressive, possibly non-conformist individuals who have been the "sparkplugs" of American industry. [5]

However, by many economic indicia, small business is enjoying a decreasing share of the economic pie. The situation is particularly acute in manufacturing, where the two hundred largest U.S. manufacturing firms increased their share of manufacturing assets from 46% in 1947 to 62% today. Sales of

---

2. See Study of the Program on Neighborhood and Regional Change, Massachusetts Institute of Technology, reported in "Small Business: Job Role Highlighted," N.Y. Times, January 18, 1980, at D1. "Small business" was defined as a firm with twenty or fewer employees.

3. National Science Board, *Science Indicators* (1977), at 92.

4. *See The Role of New Technical Enterprises in the United States Economy*, Commerce Department (1976).

5. *See e.g.*, "Dreams Prove Profitable for Small Businessman," Washington Post, January 17, 1980, at C1.

manufactured goods show a similar picture, with the two hundred largest manufacturers increasing their share from 36% in 1947 to 52% in 1972.

Not only is concentration high within the economy as a whole; it is often even higher within individual industries. A survey by the Census Bureau of 488 industries found that the four largest firms controlled over half of the market in 142 industries.

At the same time, economic theory and antitrust policy have paid insufficient attention to the role of small business in the competitive process. By implicitly assuming that all firms within a market are of equal size and financial strength, microeconomic theory fails to recognize the actual competitive conditions under which most small businesses operate, and the degree to which small businesses are vulnerable to larger, more powerful firms. As Professor Galbraith observes:

> Indeed few features of the neoclassical economics arouse more admiration for its effect than the way it rationalizes and conceals the disadvantages of the weak. One theory of the firm applies for all. There is, accordingly, no basic presumption of difference in advantage between one group of firms and another . . . [F]or no clear theoretical reason, the neoclassical monopoly is almost invariably discussed as it affects the consumer. Almost no attention is given to its control over the costs of the weaker firms from which it buys or to its control over the prices at which it sells to other and weaker firms. Thus the problem of the terms of trade within the economy, as these favor some firms and are adverse to others, is almost totally out of view.[6]

---

[6] Economics and the Public Purpose (1973), at 243.

Our failure to recognize the importance of small business has led to a number of serious failings on the part of the Government. Laws and regulations designed for application to large firms are applied with equal stringency to small businesses, even though the problems that give rise to governmental action often are caused primarily by large firms. At the same time, large firms, with the benefit of greater financial, legal and managerial resources, tend to receive a disproportionate amount of attention from Government decisionmakers in the course of regulatory and policy deliberations.[7] Small business thus finds itself in a double-bind: Included within an industry perceived to require regulatory control, yet unable effectively to influence regulatory policies.

In short, small business, though of enormous importance to the economy of the United States, has increasingly become the "forgotten man" of government policy.

How can the problems of the "forgotten man" best be analyzed, and what implications do these problems have for the FTC as an antitrust enforcement agency?

An inquiry into the problems of small business entails what may be termed "competition analysis". While antitrust principles are included within it, competition analysis encompasses many other subjects as well. Thomas Kauper, former Assistant Attorney General in charge of the Antitrust Division, has described competition policy as "a variety of actions, beyond simple enforcement of the antitrust laws, that are designed to make competition the primary regulator of our markets and to assure that competition forces exist." [8]

---

[7] See Chemical Bank Study of Concerns of Small Businessmen, reported in Business Week, November 11, 1979.

In other words, competition policy establishes the framework, including the statutes, regulations, and Government policies for action or inaction that determine the manner in which competition operates in particular industries. The question of what Government should and should not be doing has two distinct elements. Often, by "not doing", Government best assists small business' efforts to compete more effectively. To me, this is the thrust of the so-called "two-tier" regulatory reform proposals currently being considered by Congress. These proposals, which I will discuss more fully below, provide a "sliding scale" of regulation based on the size of affected firms. Through the "sliding scale" system, Government, by applying regulatory policies to small businesses less stringently than to large firms (i.e. by "not doing"), may redress the imbalance inherent in the present regulatory system. The result should be lower costs and greater productivity for small business and a greater small business presence throughout the American economy as a whole.

For this reason, issues like regulatory reform, tax policy and capital formation are intimately related to antitrust policy. With the benefit of effective Government policies in the former areas, small business will be a more vigorous competitor in the marketplace and may serve as a more effective check on the abuse of market power by large firms. The result should be a more competitive American economy and less need for the "emergency" restorative efforts entailed by the major Government antitrust case.

---

[8] See T. Kauper, Competition Policy and the Institutions of Antitrust, 23 S. Dak. L. Rev. 1, 21 (1978).

Returning to a competition analysis of small business, at least four areas deserve attention: Government Regulation; Access to Capital; Tax Policy; and Antitrust Policy.

Government Regulation

No area of Government activity has proved potentially more damaging to the competitive vitality of small business than Government regulation. Within the general subject of regulation, two issues are of particular interest; (a) the differential impact of regulation, and (b) regulation as a barrier to entry by small businesses.

(a) Differential Impact of Regulation

Practical experience and economic theory both strongly support the argument that regulatory requirements applied "neutrally" to all members of an industry often cause a disproportionately greater burden on small firms. This differential burden disadvantages small firms in their efforts to compete with large rivals.

The economic argument linking regulation and competition was articulated by Dr. Milton Kafoglis, then a member of the President's Council on Wage and Price Stability, in testimony before the Senate Subcommittee on Administrative Practice and

Procedure. Dr. Kafoglis analyzed the effect of regulation on a small firm facing a "dominant" large rival in the following terms:

> There seem to be clear economies of scale imposed by most regulatory endeavors. Uniform application of regulatory requirements thus seems to increase the size firm that can effectively compete. The cost curve of the firm is shifted upward and to the right with its minimum point . . . occurring at a larger output. If one employs the economists' theoretical "dominant firm" model and introduces such upward shifts in cost curves (the small firms' cost curve shifting more than that of the dominant firm) the share of the dominant firm will increase while that of small firms will decrease. As a result, industrial concentration will have increased. This hypothesis has not been questioned and is consistent with most of the case analyses that have been completed. It suggests that the "small business" problem goes beyond mere sympathy for the small businessman, but strikes at the heart of the established national policy of maintaining competition and mitigating monopoly.[9]

Why does "neutral" regulation have a differential impact on large and small firms? Two general observations should be made. First, even if actual regulatory costs are equal between competing large and small firms, small firms have fewer units of output over which to spread such costs and must include in the price of each unit a larger component of regulatory cost. Second, where small firms have smaller actual regulatory costs than large firms (as is generally the case), small firms remain at a competitive disadvantage because they are unable to take advantage of the "economies of scale" of regulatory compliance.

---

[9] Hearing Before the Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary, October 7, 1977, Part 1 at 26.

Large firms generally already have extensive "in-house" data compilation and reporting systems and specialized staff accountants, lawyers and managers whose primary function is regulatory compliance. Small firms, by comparison, must either hire additional personnel or purchase expensive consulting services in order to acquire the necessary regulatory expertise.

Differential regulatory costs may become critical when regulation imposes a specific technology on all firms within an industry, rather than a "performance" standard to be met by the technology of the firm's choice. Technologies favored by Government agencies tend to be the most advanced, sophisticated and expensive presently available. The imposition of a "regulatory investment" of this type on a large firm may require an adjustment of the firm's general investment plans. The imposition of the same investment on a small rival may often force the small firm to defer indefinitely necessary capital improvements. Thus, the imposition of a "neutral" technology may severely hinder the small firm in its competitive efforts vis-a-vis its large rival.

Of course, it is difficult to measure precisely the competitive effects of regulation. In some cases, less competition and higher concentration in an industry may be necessary prices for the achievement of other national goals. Nevertheless, the competitive burden imposed on small business by regulation is an issue that must be considered throughout the regulatory process.

Fortunately, the Administration and Congress have already begun a comprehensive examination of the adverse impact of Government regulation on small business. The Small Business Administration has undertaken a Paperwork Measurement and Reduction Program [10], designed to simplify Federal Government reporting forms and to eliminate duplicative information requests by Federal agencies. This effort is long overdue and will, I hope, provide a model for similar efforts by state and local governments.

More comprehensive regulatory reform efforts are also underway. During the past few years several members of Congress have introduced bills that would require regulatory agencies to tailor proposed regulations so as to avoid adverse competitive impacts on small business. While details vary among the bills, these statutory proposals generally would require regulatory agencies, in the course of rulemaking, to solicit the views of the public concerning the regulatory burden that proposed rules will impose on small business. Where an agency determines that an alternative rule less burdensome to small business is feasible and consistent with the agency's statutory mandate, the agency must adopt this rule or justify in the rulemaking record its determination that the more burdensome rule is necessary. In addition, regulatory agencies would be required over a period of years to review all "major" rules already in effect in order to determine their effects on small business.

---

[10] See Paperwork Measurement and Reduction Program Discussion Draft, "Cutting Paperwork for Small Business: An SBA Priority," U.S. Small Business Administration (1979).

The concept of "two tier" regulation deserves support by both small business and Government competition policymakers, bearing in mind, however, that in certain areas, for example, health and safety regulations, the imposition of a uniform standard probably is appropriate.

(b) Regulation as a Barrier to Entry

In addition to the differential impact of regulation, an important issue from a competition perspective is regulation that systematically excludes or impedes the entry of new markets by small firms. The FTC has become increasingly sensitive to this issues and has undertaken several initiatives.

For example, the FTC has actively intervened before the Interstate Commerce Commission and the Civil Aeronautics Board to remove restrictions on entry and pricing in the airline and trucking industries. In both areas, it is foreseeable that the dismantling, or at least the liberalization, of regulations may result in the creation and entry of smaller regional air carriers and trucking firms into markets now dominated by large companies. An illustration of this activity is our intervention in the ICC's trucking "protest standards" proceeding. To enter a particular interstate freight route, a firm is required to petition the ICC for a "certificate of convenience and necessity." When such a petition is filed, existing certificate holders, including firms that have not been actively carrying freight, may file protests against the petition. An expensive and time-consuming proceeding is thus assured, deterring many smaller truckers from petitioning in the first place. The FTC has advocated tightening protest standards by confining protests to firms actually involved in freight carriage in the relevant market. This should facilitate entry by small truckers.

Similarly, the FTC has on many occasions provided comments to and testified before the Department of Energy concerning the adverse impact of proposed DOE price and allocation rules on small petroleum refiners and marketers. These and other "deregulatory" activities will continue. Finally, the FTC's standards and certification rule, if adopted, would afford small manufacturers an opportunity to participate more effectively in the standards setting process.

Access to Capital

Access to capital has been called small business' greatest problem.[11] Indeed, policies favoring greater access to capital by small business may be the most effective method by which Government may contribute to the vitality of the small business segment of the American economy.

The critical issue in this area is whether the higher capital-raising costs of small firms reflect accurately the greater risks entailed by many small business ventures, or represent a built-in capital market prejudice against small enterprises generally. However, regardless of the nature of this discrimination between large and small firms, the disadvantages of the small firm in its capital-raising endeavors have substantial competitive consequences.

---

[11] See Testimony of Walter Stults, Executive Vice President, National Association of Small Business Investment Companies, Before the Subcommittee on Antitrust, Consumers and Employment, House Committee on Small Business, July 28, 1978.

Until a firm can break the "capital barrier", the firm will remain small and possibly capable of only a limited impact on national markets. Small firms without the benefit of capital often remain competitively vulnerable to large rivals, especially diversified firms whose operations in one market can be financed to some extent by profits earned in others. Large diversified firms have a greater ability to cut prices, to engage in expensive promotion campaigns, and otherwise to enter new markets and expand shares in existing markets.

Furthermore, even where a small firm is relatively secure in its niche, the unavailability of capital often limits the firm's ability to expand its business. This may result in a merger with a larger firm capable of providing the capital necessary for development. In this sense, unequal access to capital serves as a "barrier to mobility" within the industry.

This problem may be particularly acute in "emerging" industries. Emerging industries are industries in which one or more pioneer firms have developed and are seeking to exploit commercially a new product. This process consists of two stages; the development of a critical invention, patent or device, and the creation of a commercial market for the new product. While many firms are capable of introducing a new product and producing it on a limited basis, few have access to the capital necessary to undertake full commercial development. It is at this stage that merger or corporate affiliation with a large firm appears necessary.

The ultimate competitive effect of the acquisition of small firms by large companies is uncertain; nevertheless, the exclusion of small firms from the commercialization of important new products is troublesome, particularly in light of the fact that small business has proved itself the primary source of innovation in our economy. As William C. Norris, the founder of Control Data Corporation, recently stated.[12]

> With the exception of those hardy souls who start and operate small businesses and a few large companies, today's private enterprise is distinguished by a lack of new products and service innovations. Such innovations yield increases in productivity that permit a higher standard of living and at the same time subdue inflation and create jobs.
>
> But innovation demands risk taking - a way of life for the small-business person. It is unavoidable in starting a business and achieving profitable growth in an environment dominated by giant corporations. In short, small businesses innovate, take risks, or die.
>
> * * *
>
> Our representatives in Congress must pass new legislation that removes the disadvantage placed on small business, . . . In contrast to to the present situation, Congress would do well to give small business a competitive edge because of its willingness to innovate, take risks, and create the new jobs that Americans need so badly - in recognition of its proven performance in each of these areas.

For these reasons, the creation of greater opportunities for small firms to acquire capital should be an important priority for the Government. Unfortunately, until recently, Government capital market policy unintentionally has had almost the opposite effect: While Federal regulation of the securities markets has served the necessary function of protecting investors and maintaining the integrity of the markets, this regulation has created high barriers to the financing of small businesses.[13] Fortunately, important changes have already occured and are underway. The SEC has recently adopted a number of rules amendments that would lower substantially the cost of capital formation for small firms already regulated by SEC. In addition, the Carter Administration has proposed legislation that would permit small businesses to sell without SEC registration an unlimited amount of securities to large institutional and private investors, thus bypassing the entire regulatory system.

---

[12] Business Week, January 28, 1980, at 20.

These are welcome first steps on the road to a revitalized small business community. In order to assist this movement, the FTC has undertaken jointly with the Small Business Administration a research program designed to explore the relationship between competition and financial, tax, and business strategy considerations. The relationship between access to capital and competition will be an important area of inquiry within this study.

Tax Policy

Another area in which a growing sensitivity to small business needs is developing is that of tax policy. The relationship between tax policy and competition has not escaped

---

[13] See Testimony of Walter Stults, note 11, supra.

Congress' eye, and recent amendments to the Tax Code have provided substantial benefits to small business. For example, the 1978 lowering of the maximum tax rate on capital gains has been cited as the principal reason for a sharp increase in the amount of venture capital made available to small firms in the past two years. Since the amendment, the total money committed to venture capital firms for investment in small businesses has been approximately $1.2 billion, more than in the nine previous years combined.[14]

However, capital gains tax relief to date has been afforded across the board. No attempt has been made to tailor capital gains relief to small businesses alone. Thus, capital gains taxation, while ostensibly a "neutral" tax policy, has had unfortunate consequences from a competition perspective.

For example, under the Tax Code presently, small business owners wishing to sell their businesses are inclined to undertake tax-free stock swaps with large, "blue chip" companies in order to avoid the capital gains tax attendant to sales of stock for cash. This tends to foreclose small businesses from acquiring other profitable small businesses, since small firms generally can offer the selling owners only cash or the acquiring company's securities, which may be less stable and hence less desirable than the securities of a large firm. This promotes the acquisition of successful small businesses by large firms, and relegates small firms to a position where they must grow by internal expansion or not at all. In the context of the capital disadvantages under which most small firms already operate, the inability of these firms to grow by acquisition widens the competitive gap between large and small firms. This is precisely the trend that should be reversed.

---

[14] See Statement of Stanley Pratt, Editor, Venture Capital Journal, Before White House Conference on Small Business (January, 1980).

How can this be remedied? Several small business advocates have called for a capital gains "rollover" tax,[15] similar to the "rollover" that occurs when a homeowner sells one house and purchases another within a limited time period. Under this proposal, a stockholder, following the sale of stock in one company, would be able to defer capital gains taxation if the stockholder used the proceeds of the sale to purchase securities in a qualified small business. Capital gains taxes would be paid only after the sale of the small business stock.

The merits of the "rollover" proposal aside, the proposal serves to highlight the general tax disadvantages under which small firms operate. I believe that amendments to the Tax Code according differential tax treatment to small and large firms should be explored as appropriate means by which to strengthen the small business sector and to permit it to compete more effectively.[16] We are beginning to develop expertise in the

---

15. _See_ Testimony of Walter Stults, note 11, _supra_; Testimony of Arthur Burck, President, Arthur Burck, Inc., Before the Subcommittee on Antitrust, Consumers and Employment, House Committee on Small Business, July 26, 1978.

16. _See generally_, Testimony of Professor Alan L. Feld, Before the Subcommittee on Tax Expenditures, House Committee on Ways and Means, March 23, 1979.

competition aspects of tax policy and expect to play an increasing role in advising Congress in this crucial area.

Antitrust Policy

As is evident from this discussion, competition analysis encompasses many subjects. However, no subject may be of greater importance to the small business community than the enforcement of the antitrust laws. In discussing the impact of antitrust enforcement on small business, it is useful to focus separately on two different sectors of the American economy, manufacturing and distribution.

(a) Manufacturing

Small firms in the manufacturing sector are in a difficult situation, particularly in consumer goods industries. These industries have become increasingly characterized by heavy advertising, often accompanied by artificial brand proliferation. Small firms seeking to enter or expand in these industries face an almost insurmountable capital barrier, and, as a result, are often either totally excluded from the market or locked permanently into small regional markets. Even in such regional markets, small firms may remain vulnerable to the market power of large national rivals. For example, the "beer wars" between major national brewers in the 1960's may have driven many small local and regional brewers from the market. Whether or not this activity should be challenged under the antitrust laws is a difficult question for the antitrust enforcer.

Unquestionably, some advertising and promotion serves the consumer and is procompetitive, though sometimes small firms may be unavoidably disadvantaged. In other cases, advertising and promotion may be anticompetitive, as when firms with existing large market shares employ these practices with the intent of driving smaller rivals out of business or excluding potential competitors from the market. The critical question from a law enforcement perspective is to differentiate between the pro and anticompetitive uses of what may appear to be legally neutral marketing techniques.

The Bureau of Competition believes that advertising and promotion contributed to substantial entry barriers in an important pending case, the Kellogg ("Cereals") case. In this case, we allege that the three largest manufacturers of ready-to-eat cereal created a large number of artificially differentiated products whose intensive advertising has created a barrier to entry by other firms.

The issues raised in the Cereals case are difficult and require the reexamination of existing theories of exclusionary conduct. Nevertheless, I believe that antitrust enforcement authorities should place increased emphasis on examining the predatory and exclusionary activities of dominant firms if efficient smaller firms are to have a chance to survive in the market and to offer consumers an alternative.

(b) Distribution

Small firms engaged in the distribution sector of the economy face a different, although equally serious, set of competitive problems than those faced by small manufacturers.

To begin with, the presence of small business in distribution is statistically much more significant. For example, in 1977, retailers with assets of $10 million or less accounted for 58% of all retail sales, 50% of net retail income, and 52% of total retail assets. The importance of these figures from an antitrust perspective is inescapable. As one observer has noted, "small business probably comes in contact with antitrust policy more in the field of distribution, simply because of the predominance of small business in the distributive trades." [17]

Small businesses engaged in distribution are frequently caught between "a rock and a hard place." First, distributors suffer indirectly from imperfect competition at the supplier level. As suppliers merge or are driven out of business, fewer distributors generally are needed to serve the needs of the remaining large suppliers. [18] Alternatively, suppliers seeking to maximize their own profits may impose vertical restrictions on distributors. Such restrictions may limit the distributor's freedom to determine its prices, terms of sale, range of products offered, customers and geographic markets.

In addition, small distributors may face competition with large distributors acting as "power buyers", who seek to extract more favorable terms from suppliers than can be obtained by small firms.

---

[17] Holton, "Antitrust Policy and Small Business," in Phillips, ed., PERSPECTIVES ON ANTITRUST POLICY 195 (1965).

[18] See Testimony of John White, Executive Vice President, National Beer Wholesalers Association, Before the Subcommittee on Antitrust, Commerce and Employment, House Committee on Small Business, July 28, 1978.

The FTC has actively pursued these problems through various law enforcement programs. For example, the FTC has recently promulgated a rule governing the sale of franchises. This rule requires franchisors to disclose to prospective franchisees, who are almost all individuals or small businesses, material information concerning the historical success (and failure) of past franchises, and other information relevant to the prospective franchisee's decision to purchase the franchise.

The FTC has also pursued distributional issues through litigation. In the area of resale price maintenance, we have entered into a settlement with Levi-Strauss Company barring that clothing firm's policy of restricting discounting practices by retailers of Levi products. Similar settlements have been obtained in cases involving manufacturers of audio components. These settlements have been instrumental to the growth of the audio market generally, and the growth of a strong "discounter" segment in particular.

Exclusive dealing contracts have been another traditional method by which large suppliers have restricted the competitive freedom of small firms. In an important challenge to a system of exclusive dealing, the FTC has brought suit against General Motors for its refusal to market repair automotive body parts to anyone but its franchised dealers. Over 30,000 independent body shops are thereby forced to acquire repair parts from GM dealers, who are their competitors for the repair of GM cars. Although the Administrative Law Judge recently held that this practice did not violate the antitrust laws, the Bureau continues to believe in the validity of the complaint and has appealed the case to the Commission.

. In a suit against the only publisher of a comprehensive listing of all U.S. commercial passenger flights, the FTC recently found that the Reuben H. Donnelly Corporation, by refusing to list flights of smaller intrastate or commuter airlines in the same tables and on the same terms as those of larger airlines, has unreasonably restrained competition between the commuter lines and the large carriers. This is a potentially important holding for the small business community since it declares that a monopolist has a duty to deal fairly, even when its alleged "unfairness" is not directed at incipient or potential competitors.

Another important aspect of the FTC's law enforcement mission historically has been the enforcement of the Robinson-Patman Act. The FTC recognizes that, to the small business, the availability of products at prices and upon terms substantially the same as those offered its rivals is essential if the small firm is to survive. However, because price discrimination cases often have proved enormously costly in terms of resource commitment, the FTC must focus on those cases with the largest potential industrywide deterrent effect. Such cases usually involve large, national sellers in concentrated consumer industries, and often will involve price discrimination in favor of national "power buyers."

However, notwithstanding the costs of law enforcement, the FTC remains committed to the protection of the integrity of the distributional system. During the past decade it has become fashionable to declare that "antitrust protects competition, and not competitors." This view, based ostensibly on a very strong commitment to principles of short-term allocative efficiency, loses sight of the essential fact that there can be no competition without competitors. The importance of a diversity of firms in our markets generally, and of small firms in particular, runs throughout the legislative histories of the antitrust statutes. In my view, the goals of the small business movement today reflect and are consistent with the central principles underlying the concept of antitrust.

As noted earlier, competition analysis entails an examination of what Government should and should not be doing. Until now I have been discussing the role of Government as the guardian of a fair market place in which small business can compete (the "should" question); but what of the role of Government as a prosecutor of small business? What kinds of cases should and should not the Government be bringing against small businesses? Or, more fundamentally, should small businesses always be judged by the same antitrust rules applicable to large businesses? If differential treatment for large and small firms is appropriate in the areas of Government regulation, access to capital and tax policy, why not in antitrust enforcement?

This is a very difficult question for an enforcement agency. Clearly, under certain circumstances, for example, where a group of small firms dominates a highly concentrated regional market, concerted action among them can substantially injure consumers. Similarly, a boycott by small firms of another small firm can have a significant adverse impact on both the boycotted firm and the market. These observations suggest that a blanket immunity from antitrust prosecution for small business is clearly inappropriate.

However, it is equally necessary to recognize that antitrust enforcement officials, in their exercise of prosecutorial discretion, generally should consider both the nature of the practice and the market power of the parties. Practices that clearly violate the antitrust laws when undertaken by large firms may have relatively insignificant anticompetitive effects when undertaken by small firms in the same market. Furthermore, such practices may be necessary in order for the small firms to compete more effectively with their large rivals.

For this reason, I believe that the antitrust authorities should move cautiously in certain areas, for example, when small businesses have established buying cooperatives engaged in joint advertising campaigns, or created joint research and development programs in order to achieve efficiencies already available to large "power buyer" or "power seller" competitors.

Conclusion

In conclusion, small business, as a provider of jobs, new goods and services, and national wealth, has a vital role to play in the American economy. However, if this role is to continue, a greater sensitivity must be developed by Government to small business problems. Government policymakers, too long concerned exclusively with the problems of big business, must begin to recognize that there are two distinct business communities, rather than one, in the United States. The economic health of our Nation depends on a competitive balance between them. Clearsighted and effective Government policies designed to maintain this vital balance are long overdue.

EXHIBIT 3.—STATEMENT OF MR. ALFRED DOUGHERTY ON THE ACQUISITION OF FEDERAL GLASS CO.

STATEMENT OF
ALFRED F. DOUGHERTY, JR.
DIRECTOR,
BUREAU OF COMPETITION
FEDERAL TRADE COMMISSION
IN RESPONSE TO STATEMENT OF
CONGRESSMAN SAMUEL L. DEVINE
LANCASTER COLONY CORPORATION ACQUISITION OF
FEDERAL GLASS COMPANY, FTC DOCKET NO. 9119

I am responding herein to the prepared statement of Congressman Devine delivered before the Subcommittee on Consumer Protection and Finance of the House of Representatives regarding the actions of the Federal Trade Commission and of the Bureau of Competition in the challenge to the above referenced acquisition.

This response undertakes a point-by-point analysis of Congressman Devine's statement. I have attempted to avoid repetition and have focused on the most significant points in Congressman Devine's statement. Therefore, my failure to specifically address a point in Congressman Devine's statement should not necessarily be taken as agreement with that point.

I have attempted to cite references to the public record and to less sensitive facts contained in documents in the Bureau's files, in support of my statements. The precise figures regarding the sale or profits of Federal Glass and other members of the industry are considered confidential business or financial information, for which confidential treatment has been requested.

1. "... the Federal Trade Commission took precipitous action...."

Neither the actions of the Commission, nor of the Bureau, were "precipitous." The Bureau began an investigation of the proposed sale of the Federal Glass Company, a division of Federal Paper Board Company, Inc. (Federal), to Lancaster Colony Corporation (Lancaster) in March of 1977, over two years ago. An exhaustive investigation was conducted which involved every company in the table glassware industry, the industry trade association, and numerous buyers and distributors of glassware. The Bureau staff also extended an offer to Federal and Lancaster to submit their positions on the issues involved, which submittals were sent to the Commission with the Bureau's recommendations.

Thereafter, an injunction preventing the merger was issued by a judge of the United States District Court for the Southern District of New York, following presentation by counsel for Federal and Lancaster of evidence and arguments in rebuttal of the Bureau's position in seeking that injunction. After reviewing the facts and arguments presented by the parties, the court stated:

> "Since there is a likelihood that the acquisition will ultimately be found to violate Clayton § 7, it necessarily follows that there is a substantial likelihood that the acquisition would violate Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45." F.T.C. v. Lancaster Colony Corp., 434 F. Supp. 1088, 1096 (S.D.N.Y. 1977).

Again, in March of the following year, 1978, the Bureau's staff met with Federal's representative and informed him that, in the absence of evidence showing changed circumstances, the Bureau would continue to oppose the sale of Federal Glass to Lancaster. Thereafter, Federal and Lancaster raised the issue of the "failing company" defense, and requested a new investigation.

Rather than merely rely on the legal precedent already established, the Bureau's staff again investigated the proposed sale for a period of six months. That investigation not only dealt with financial issues relevant to the alleged "failing company" defense, but reexamined all the elements of market, competition and other matters previously litigated, but still contested by Federal and Lancaster.

When the Commission again issued a Complaint in October 1978 challenging the sale, the Bureau staff immediately contacted Federal and Lancaster and requested that, before any drastic steps were taken such as closing the plant, the Bureau be contacted to determine whether an agreement could be reached to prevent such an action. Such an agreement might have included withdrawal of the administrative bar to the acquisition, thereby permitting a sale of Federal Glass to Lancaster. Thereafter, the merits of the allegations contained in the Complaint would be litigated. In fact, the Bureau staff made just such an offer to Lancaster on its own initiative after the closing of the plant. That offer was rebuffed.

The offer to discuss the possibility of an accommodation was kept open by the Bureau's staff and communicated to Federal several times before the closing. The offer was, in fact, repeated immediately following a hearing on December 28, 1978, at which the staff's concerns about a possible closing were disparaged by Federal's counsel as unfounded.

The term "precipitous" may be appropriately used, however, to describe Federal's actions against the interests of its employees. John Runyon, immediate past chairman, Glassworkers Local 603, stated in open hearing before the Administrative Law Judge, that the closing of Federal Glass in this fashion was "unprecedented in the history of the industry." Hearing Transcript, February 7, 1979, at 64.

2. "Federal Glass was a very weak third in the industry making 85% blown glassware with no retail sales."

To the contrary, Federal Glass was a strong factor in the market, with over 11% of the moderate-priced machine-made soda-lime glassware market. Its sales were in excess of $50 million, and substantially more than Lancaster, which, nevertheless, was highly competitive and profitable.

Federal's own figures show not only that it did have retail sales, but that those sales were growing. (Federal Annual Report, 1976 at 10-11, 1977 at 20). In fact, Federal Glass sales personnel considered retail sales to be the area most emphasized for growth. (E.g., Spengler Testimony at 37; Grady Testimony at 25). 1/

Further, most companies in the glassware industry, including Federal and Lancaster, sell their products in each category recognized by the American Glassware Association (AGA). Hoover Testimony, at 46-47. Those categories are: 1) Beverageware; 2) Tableware; 3) Food Preparationware; and 4) Ornamental

---

1/ (All testimony refers to the Investigational Hearings held June 1-3, 1977, unless otherwise specified. All witnesses were officials of either Federal or Lancaster, and are identified fully at pages 12-13.)

and Novelty Glassware. 2/ Both Federal Glass and Lancaster are now or were members of the AGA at the time that the Commission first challenged the acquisition. Some such products are sold to institutions, such as restaurants, are sold through retail, or are given away to consumers as premiums. Nonetheless, if they perform the identical functions and are indistinguishable, they are the same products and constitute the same product market for antitrust purposes, however sold. The Commission and the federal courts recognized this interrelationship in e.g., Papercraft Corp., 78 F.T.C. 1352, 1401-04 (1971), mod., 79 F.T.C. 420 (1971), aff'd, 472 F.2d 927 (7th Cir. 1973). The distinctions suggested by Federal and Lancaster are not meaningful and do not diminish the seriousness of the acquisition as anticompetitive.

The point primarily relied upon by Federal and Lancaster, and echoed in Congressman Devine's statement, is a purported distinction between machine-blown and machine-pressed glassware. That distinction is not meaningful and is not supported by the facts in the record.

The courts have recognized clusters of products, such as in the glassware industry, to be an appropriate "product market" in which to analyze anticompetitive effects. Among other factors, the reasonable interchangability of use between products is important in determining the relevant product market. 3/ Most common items of glassware can be made by either blown or pressed methods, 4/ choices often

---

2/ American Glassware Association Reporting Procedures, at 2-6. See also, Mallet Testimony, pp. 82-83.

3/ Brown Shoe Co. v. United States, 370 U.S. 294, 325 n. 42 (1962). Scherer, Industrial Market Structure and Economic Performance at 53 (1970).

4/ See, Mallett Testimony, at 145. The district court had before it, samples of identical appearing glassware made by both machine-pressed and machine-blown methods. Affidavit of Brian H. Siegel, Exhibit I, Attachment 2 & 3 (Attachment A).

being dictated by efficiencies or availability, as well as some peculiarities of design which may make one method preferable to another. Federal and Lancaster have continuously pointed to this latter element--design--as the critical factor distinguishing pressed from blown glassware. However, to accept this argument would be to say that tumblers, for instance, with a curved shape are not interchangeable with tumblers of equal size, weight and capacity, but with straight sides. Such an obvious, logical extension of the companies' arguments makes clear their inapplicability.

The testimony, both of Federal personnel and other glass industry members interviewed by staff, shows that pressed and blown machinery customarily function side-by-side, using the same glass furnaces, and usually supervised by the same personnel. 5/

Other factors recognized by the courts in determining the appropriate product market are:

1) Commonality in production. 6/ Other than the actual forming equipment, all other equipment and material, from the furnaces to the packaging and handling facilities, are identical for production of pressed and blown glassware. Mallett Testimony, 14-32. In addition, the glassworkers union does not recognize a classification difference between pressed and blown machine operators. Mallory Testimony at 27; Mallett Testimony at 75.

2) Commonality or synergy in marketing. 7/ All AGA members including Federal and Lancaster, attend the same trade shows (Hoofstetter Testimony, 47-49; Mallett Testimony, 86-88); Federal and Lancaster attempt to sell to the same purchasers, and continue to do so even if unsuccessful (Hoofstetter Testimony, 71; Hoover Testimony, 61; Scholz Testimony, 30); and the same salesmen attend all the trade shows, and carry all products, and may service all types of customers, within their geographic territories (Spengler Testimony, at 18; Grady Testimony, at 17; Scholz Testimony at 16-17; Hoover Testimony, at 28; Hoofstetter Testimony, at 63).

5/ Mallory Testimony, 28-30.

6/ Golden Grain Macaroni Co., 78 F.T.C. 63 (1971), aff'd, 472 F.2d 882 (9 Cir. 1972), cert. denied, 412 U.S. 918 (1973).

7/ United States v. Wilson Sporting Goods Co., 228 F. Supp. 543, 551-52 (N. D. Del. 1968).

3) Buyers' preference to purchase many items from one supplier. 8/ Buyers apparently tend to want fewer sources of merchandise primarily in order to minimize shipping costs, which are important on low cost, high weight items.

4) The majority of significant firms offer a full or nearly full line of product. 9/ Federal and Lancaster are considered to be full line glassware companies by their own executives. Hoover Testimony at 43 (Lancaster has 2,000 items); Hoofstetter Testimony at 37 (Lancaster has 1,500-3,000 items); Mallett Testimony at 81-83 (Federal is full line, with 2,000 items). Federal's own counsel indicated that Anchor Hocking had only 2,700 items. (Transcript of Preliminary Injunction Hearing, July 7, 1977, at 89. Hereinafter Hearing Transcript).

5) The clustering of that group of items in the same section of a retail store. 10/ The catalogs and advertising of glassware, even by Federal and Lancaster, do not make any distinction between pressed and blown glassware. (E.g., Spengler Testimony, at 46).

After reviewing the voluminous record created by the Bureau's staff, regarding the above elements of proof and others of record, Judge MacMahon found, at p. 1093 of his opinion:

> Both machine-pressed and machine-blown glassware are recognized as one industry. Although pressed glassware is somewhat heavier and has a slightly different appearance, many items can be made through either process. They serve the same general uses, are produced in the same factories, and require the same production facilities. Except for the fact that they are formed on different machines, they are produced from the same raw materials and the same molten glass; sold at substantially the same price; sold and advertised together without reference

---

8/ United States v. Philadelphia National Bank, 374 U.S. 321 (1963).

9/ A. G. Spalding & Bros., Inc. v. F.T.C., 301 F.2d 585 (3 Cir. 1962).

10/ Liggett & Meyers, Inc., 87 F.T.C. 1074, 1161, n. 23 (1976).

> to the production method; purchased by the same customers; displayed in the same section of stores; recognized by the industry members as competitive; and generally not distinguished by ultimate consumers.

The illusory nature of this alleged distinction between pressed and blown glassware is perhaps best illustrated by the efforts by glassware manufacturers to eliminate minor appearance differences caused by the manufacturing process. For example, the seam left by press molds are removed by glazing, 11/ and Federal has a substantial investment in and has relied upon a process for eliminating another one of the minor appearance differences between pressed and blown glass, the shape of the rim. 12/

Even were the Commission or the courts to accept Federal's position, it must be noted that Federal is a significant producer of pressed glassware, producing approximately 15%-20% of its volume by that method, 13/ and has substantial excess machine pressing capacity. 14/

3. "Lancaster Colony assumed that they would be a small full-line competitor to the two giants."

After the acquisition, Lancaster would not have been "small" by anyone's measure. They would have held 18.1% of the relevant market in 1976. Anchor Hocking, one of the "giants," had, by way of contrast, only 23% of that same market. The combined share of the market which would have been enjoyed by the combined Lancaster/Federal firm in 1977, would have jumped to over 20%, while Anchor Hocking's

---

11/ "Glazing" is done by sending the glassware through a piece of equipment which heats the glass to cause the surface to flow slightly and smooth out. From that point it is cooled through a lehr, just as blown glassware is cooled.

12/ *E.g.*, Grady Testimony, at 33.

13/ Hearing Transcript, at 80.

14/ Federal has 12 or 13 pressing machines (Mallett Testimony, at 46), while Lancaster itself operates with just 12 pressing machines (Hoofstetter Testimony, at 18-23).

share had remained fairly stable. 15/ Federal's sales again increased in 1978 by over 15%.

MARKET SHARES

Machine-Made Soda-Lime Glassware

Company	1976 Sales ('000)	 Market Share (%)
Owens-Illinois	119,250	28.0
Anchor Hocking	98,685	23.1
Federal Glass	47,006	11.0
Brockway Glass	40,522	9.5
Lancaster	30,104	7.1
Durand	13,457	3.2
Jeannette Corp.	13,183	3.1
Bertlett-Collins	7,465	1.8
Corning Glass	0	0
Other Imports	52,836	12.4
Other Domestic	3,696	0.9
	426,204	100.1

1976

combined market share = 18.1
4 firm concentration = 71.6
4 firm concentration after = 78.7

1977

combined market share = Over 20.0
4 firm concentration = 75.6
4 firm concentration after = 82.4

15/ The precise figures for 1977 are considered to be sensitive commercial information by the companies, and were obtained by the Bureau's staff on a promise of confidential treatment.

4. "They [Lancaster] never thought of the FTC in a serious way as Federal felt they would increased [sic] competition with the merger and the American consumer would benefit."

This very claim was advanced by Federal's counsel, Mr. Wolfe, before the United States District Court in 1977. 16/ However, Judge MacMahon found:

> "[I]t was surely no surprise to respondents that the acquisition might be challenged as violative of the antitrust laws. That such a challenge was foreseen is clear from respondents' agreement permitting Lancaster to withdraw its offer to acquire Federal's assets if the acquisition was challenged as violative of the antitrust laws." (434 F. Supp. at 1097).

Regardless of the companies' analysis of the antitrust issues the first time, it is not believable they could be so euphoric when the sale was attempted for the second time in 1978. It then followed: 1) an injunction in 1977 prohibiting the acquisition; 2) entry of a Consent Order in February, 1978, restricting the ability of Federal and Lancaster to again attempt such a sale; 3) a refusal in March 1978 by staff to withdraw opposition to the sale; and, 4) a letter on June 23, 1978 from the Director of the Bureau, Alfred F. Dougherty, Jr., stating the Bureau's opposition to the proposed sale.

A claim that a challenged merger will enable that particular company to compete more strongly against larger members of the industry, does not act as a defense when an acquisition may adversely affect competition as a whole. The courts have specifically rejected such a position, as stated by Judge MacMahon in his opinion at p. 1096:

16/ Transcript of Hearing, July 7, 1977, at 85.

> "Nor is there merit in respondents' contention that the acquisition will enable the resulting firm to compete more vigorously with the two largest glassware producers and thereby increase the vigor of competition. United States v. Philadelphia Nat'l Bank, supra, 374 U.S. at 370, 83 S. Ct. 1715."

5. "Later it was discovered this [a request by the FTC for information] was due to the complaint of Anchor and Owens about the merger."

I can say categorically that this allegation is false. The sale of Federal Glass was first noticed by the Bureau's staff from a newspaper article on March 7, 1977, and an investigation recommended by the staff on March 11, 1977. Subsequently, an investigation was authorized by the Bureau's Merger Screening Committee. That Committee, made up of Bureau of Competition and Bureau of Economics staff members, reviews all proposed mergers or acquisitions involving a substantial amount of commerce.

The investigations conducted by the Bureau's staff produced voluminous records which overwhelmingly demonstrated the anticompetitive nature of the proposed transaction.

In both the 1977 and 1978 investigations the Bureau staff contacted every significant glassware manufacturer that participated in the United States market. Firms contacted in both investigations included the following: Brockway Glass Company, Jeannette Corporation, Bartlett-Collins Company, Corning Glass Company, Owens-Illinois Corporation, J. G. Durand International, and Anchor Hocking Corporation.

Officials of each of the above mentioned firms were interviewed by the FTC staff regarding, among other matters, competition between pressed and blown glassware, and between glassware products and plastic, ceramic and paper products. The information obtained in those interviews was supported by the glassware industry trade association, and by purchasers and sellers of glassware products. Throughout this entire episode, neither Federal nor Lancaster has produced any evidence to contradict the Commission's evidence. They have produced three (3) conclusory affidavits and their own, unsupported statements of belief. Such statements were provided in response to the requests of the Bureau staff for the positions of the respondents, both in 1977 and 1978.

Representatives of Anchor Hocking and Owens-Illinois were contacted and did cooperate to some extent in the investigation, as did other members of the industry, except the respondents themselves. Their actions, however, did not exhibit any overriding interest in helping the Commission to prevent the merger, and their cooperation was not always easily obtained. For example, both Corning Glass Works and Owens-Illinois refused to provide the staff with requested data in 1978, until after lengthy negotiations for the protection of that data, and after the staff had convinced those companies of the importance of that data for an accurate analysis of the glassware industry.

The affidavits executed by responsible corporate officials of Anchor and Owens, at the request of the Bureau staff, reflected only the statements of those officials, and were in conformance with the evidence and testimony of other industry members, the trade association, consumers of glassware, business and economic experts, 17/ and glassware buyers. 18/ It would have been irresponsible for the staff to have ignored other important competitors in the course of this investigation.

The staff found very little awareness by glassware buyers of the competitive distinctions and separate submarkets alleged by Federal and Lancaster. In fact, the glassware advisor for the largest, most prestigious department store buying service, Associated Merchandise Corporation, was

---

17/ E.g., Affidavit of Jessee W. Markham, Ph.D., Graduate School of Business, Harvard University. (Attachment B)

18/ E.g., Affidavit of Donald Barber, Merchandise Manager, Houseware and Dining Service Departments, J. C. Penney Co.

totally ignorant that there were two methods of producing machine-made glassware. The important distinction, staff was told, was between hand-made and machine-made glassware. 19/

The most significant evidence in this case, however, came from investigational hearings the staff held on June 1, 2 and 3, 1977, at which the sworn testimony of ten corporate officials of both Federal and Lancaster were taken. Among those officials were: Harold C. Mallett, Senior Vice President of Federal Paper Board Company, Inc., and Divisional President of Federal Glass; John E. Spengler, Vice President of Sales and Marketing, Federal Glass; G. Richard Mallory, Vice President for Manufacturing, Federal Glass; James F. Hoofstetter, President, Indiana Glass Company; and Wilbur C. Hoover, Vice President and General Sales Manager, Indiana Glass Company.

That testimony was introduced in full into the record in the Bureau's motion for a preliminary injunction. (Exhibits to the Complaint, Vols. E-1, E-2 and E-3). That testimony provided the majority of evidence before the district court, and it was primarily on that testimony that the Bureau staff based their arguments.

6. "A Federal Judge in New York City, unbelievably, in July granted this injunction. He later told counsel he had been sick and had not studied the case and was surprised Lancaster Colony had not been able to complete the merger."

It defies credibility to believe that a judge of a United States District Court would take the position that he had acted in ignorance in granting the extraordinary remedy of a preliminary injunction. Judge MacMahon's written opinion clearly shows that this allegation is without foundation. Judge MacMahon noted in that opinion that Federal and Lancaster had argued to the court that:

> "the planned acquisition will be abandoned if the preliminary injunction is issued ...."

19/ *E.g.*, the divisional president of Federal Glass in 1977 testified that hand-made and machine-made glassware were significantly different. Mallett Testimony, at 112.

Furthermore, the injunction issued on July 21, 1977, a full month after the Commission had filed its motion for such action on June 21, 1977, and two weeks after a full day hearing before Judge MacMahon was held on July 7, 1977.

7. "Federal determined that it was too expensive to go on."

The only expense remaining at this point was presentation of evidence before the Commission's Administrative Law Judge, a process which could easily have been expedited, as suggested by the Commission staff at the preliminary injunction hearing in 1977. 20/ In fact, the Bureau staff agreed in the Consent Order to expedite a trial on the merits, should the parties again seek to consummate the sale. (Attachment C)

As Congressman Devine later points out, there was substantial expense to everyone involved in reopening the investigation in 1978 at the request of Federal and Lancaster, particularly to the Commission. At the time Federal closed the plant and sought to withdraw from litigation a second time, ten months had passed since Federal itself had requested a new investigation. The Bureau's staff was only two weeks from presenting Federal with its witnesses, documents, and proposed testimony in preparation for a trial on the merits of the Complaint. 21/

8. "Estimated 1978 sales of Durand [a French glassware manufacturer] was $55 million and estimated 1979 at $76 million. They were now larger than Federal and Federal was losing money."

J. G. Durand International, a U.S. subsidiary of a French concern, had 1976 sales of $13.5 million, or 3.2% of the market to Federal Glass' 11%. Its 1977 sales were slightly lower. The Bureau's staff does not have access to

---

20/ Hearing Transcript, at 62.

21/ Report of Prehearing Conference held 12/28/78, at 4 (Attachment D).

1978 or 1979 figures, but are informed by Durand that 1978 sales were expected to be approximately the same as, or slightly higher than 1977.

We expect, without actual knowledge, that the figures quoted by Congressman Devine are for total glassware imports, including expensive, leaded crystal stemware, which is not included in the relevant market examined in connection with the Federal Glass sale.

> 9. "So, in April 1978, Lancaster went back to the FTC to tell their story again, adding the above factors."

Although I did meet with the respondents in April, it was in March 1978 that one of the parties first approached the Bureau of Competition regarding the possibility of re-examining the acquisition proposal. That company was Federal, not Lancaster. At that first meeting, the question of Federal Glass's financial performance was not discussed. Instead, the respondents' previously rejected position that the acquisition was not anticompetitive was merely reiterated. It was not until the second meeting, in April, that the issue of Federal's financial condition was raised with me.

It is important to note that not once in the preceding 13 months had Federal thought to raise this issue. In fact, counsel for respondents expressly rejected reliance on the "failing company" doctrine when questioned by Judge MacMahon during argument on the Commission's motion for a preliminary injunction. 22/ In fact, Federal never did actually plead the "failing company" defense until January 26, 1979, five days before the plant was closed. The prior claims were always couched in terms of a possible closing being one option open to the company, not the only course open to Federal. (*E.g.*, letter of July 6, 1978 to Alfred F. Dougherty, Jr., from John R. Kennedy).

It should be explained that Federal never approached the problem of divesting Federal Glass by seeking the best possible sale arrangement, exclusive of Lancaster. The entire energies of both respondents were channeled solely into forcing a sale to Lancaster, regardless of whether

---

22/ Hearing Transcript, at 120.

alternate purchasers existed. Had Federal expended its energies in 1977 on locating an acceptable alternative purchaser at a realistic price, the events of the past months may well have been avoided.

When Federal first raised the issue of the alleged poor financial performance of Federal Glass, the documents supplied by Federal itself did not support its argument. Instead, they showed that Federal Glass had an operating profit turnaround of an increase of more than $1 million over the previous year.

From this point on Federal Glass appeared to decline, but it is difficult to separate this trend from Federal's efforts to institute the sale to Lancaster. This time period coincided with Federal's attempts to establish the failing company defense. Furthermore, public stories during this period of Federal's claims and of its consideration of closing Federal Glass kept the market in a state of uncertainty. During Investigational Hearings held on October 16, 1978, Sidney J. Pope, the Comptroller of Federal stated under oath that:

> "There is no question in my mind but what the uncertainty hanging over that division is a major contributor to the losses they are experiencing."

Although Federal officially claimed poor performance, this pessimism was not shown by Federal elsewhere and lacks credibility. Despite the apparent losses shown by Federal Glass documents, on several occasions Federal officials informed the Bureau staff that the latter half of each year was the most profitable period for Federal Glass, and that the division was expected at least to break even for 1978. In fact, on the very day that notice of intent to sell Federal Glass was served on the Bureau, the President of Federal informed the Bureau's staff that he anticipated Federal Glass would break even for 1978, a fact also represented in the brochure offering Federal Glass for sale, prepared by First Boston Corporation.

Finally, to the extent there was declining performance shown by the figures supplied by Federal, these figures may be at least partially attributable to extraordinary charges against the division for, among others, capital expenditures and for acceleration of deductions for doubtful accounts. In effect, every effort was made to make Federal appear to be less successful than it was or could be.

In 1977 Federal withheld the expenditure of funds for necessary capital improvements. (Mallett Testimony, at 126). That decision had three effects. First, it substantially increased the cash drain in a single fiscal year, 1978, when it was necessary to "catch up." Second, the failure to correct the problems probably caused production difficulties in 1978 as a result of poorly functioning furnaces, forming equipment, and inefficient material handling and storage, all areas slated for improvement. Third, the need to make more than normally scheduled repairs, resulted in lengthy shutdowns of up to 60% of Federal Glass's capacity at one time or other. This probably created massive inefficiences due to shut down and start up time, as well as minimum operating volumes for profitable use of Federal's large facilities.

In the 4th period (April) financial statement for 1978 alone, allowances for doubtful accounts jumped from the historic figure of $15,000 to $115,000. Although Federal contends it can substantiate the legitimacy of this account write off, it seems convenient that the need to do so occurred only after unsuccessful efforts to convince the Bureau to reverse its opposition to the acquisition.

> 10. "Federal had lost about $1
> million in the first quarter
> of 1978."

The division profit and loss statement for the first quarter of 1978, supplied by Federal showed an operating profit of nearly one-half million dollars and a net profit, even after arbitrary corporate allocations. This represented an increase of approximately $1.2 million over the same period in 1977, when Federal disclaimed that Federal Glass was "failing."

> 11. "So, Federal, to cooperate,
> hired First Boston Corporation
> to look for another buyer.
> This they did for sixty days
> with no success."

It is not a question of cooperation with the Bureau of Competition, but one of proof that no alternate purchaser existed. Federal was under a burden to establish vigorous, good faith efforts to locate alternate purchasers if it wished to rely upon a "failing company" defense. Given Federal's complete lack of any effort in this regard up to the summer of 1978, I tried to ensure that every effort was made to avoid the unnecessary option of closing the Federal Glass plant.

Although Federal retained an investment banker to market the glass division, the terms of that retainer made a negative outcome a foregone conclusion. When retained in July 1978, First Boston Corporation was informed by Federal officials that, if a buyer were not located by August 28, 1978, Federal would serve the Bureau with a notice of intent to pursue the sale to Lancaster. Therefore, because negotiations for sale of a company such as this normally require six months, and a company which requires "turnaround" effort even longer, First Boston was forced into an untenable position. The brochure was hastily assembled, primarily with data and information supplied by Federal and not generated by First Boston, and the agents of First Boston were required to press companies for an immediate answer to their inquiries. 23/ Under such circumstances, those answers were, of course, negative. Such responses were also encouraged by the brochure, which mentioned only a price of approximately $40-$45 million for Federal Glass, a figure more than double the independently appraised value of that company.

> 12. "Finally, in late January 1979, Federal gave up and closed the plant laying off 1,500 people. Still the FTC would not believe it was a failing operation."

Federal closed the Federal Glass plant on January 31, 1979, while negotiations were still proceeding with an employee group interested in acquiring the division, and apparently before the Economic Development Administration had formally acted on certain loan guarantee requests made by those employees. That closing took place despite repeated overtures by the Bureau to Federal and Lancaster to notify the Bureau before any drastic measures were taken, such as closing the plant.

The "failing company" defense is very specific, and requires proof of three elements: first, that the company is in imminent danger of bankruptcy; second, that the prospects for rehabilitation are remote, including reorganization through bankruptcy; and third, that no alternate purchasers exist. (International Shoe Co. v. F.T.C., 280 U.S. 291 (1930); Citizen Publishing Co. v. United States, 394 U.S. 131 (1969). At the time of closing, Federal had not established proof of any one of these elements.

23/ The Bureau staff was informed by a First Boston representative that experience dictated a minimum of six months to successfully negotiate such a sale. Although initial contact time may be accelerated by employment of additional personnel, negotiations following first contact should take three or four months.

First, Federal Glass is a division of Federal Paper Board Company, Inc., a profitable member of the "Fortune 500." As such, it was in no danger of bankruptcy. Moreover, analysis of the financial statements provided by Federal showed that Federal Glass was actually profitable, and would be in no danger of failure as an independent corporation. 24/

Second, analysis of Federal's business documents, the reports of Federal's retained consultants, 25/ and the testimony and statements of Federal's own executives, 26/ disclosed concrete plans to "rehabilitate" Federal Glass which would make it an even stronger, more profitable company.

Certainly, Lancaster's willingness to pay a large sum of money for Federal Glass shows that Lancaster believed that Federal could be profitable. In fact, testimony of Lancaster officials disclosed plans to improve efficiency and reduce costs. 27/ Lancaster did not have some inherent ability to succeed where Federal would have failed, they were merely willing to undertake the effort. In fact, Lancaster had originally asked the operating head of Federal Glass to remain with the division after the sale. 28/

Third, Federal strongly resisted suggestions that it seek out alternative purchasers, only reluctantly seeking such purchasers after the weakness of its position was pointed out. I have already addressed the cursory nature of Federal's efforts in this regard. I want to stress, though, that there were still potential purchasers known to be outstanding by Federal at the time the plant closed. In fact, as stated in the Bureau's Motion to Withdraw from Adjudication and to Dismiss the Complaint (Attachment E), it was not until February 23, 1979, that the last of those alternate purchasers withdrew from negotiations, under heavy pressure.

24/ The staff hired Professor Edward I. Altman, Ph.D., of New York University, as an expert financial consultant. Dr. Altman concluded, based on data supplied to him by Federal and every member of the industry, that Federal Glass was not a "failing company," even when analyzed as an independent company.

25/ E.g., First Boston Offering Brochure, at 1, and Exhibit VII.

26/ October 16, 1978 Testimony of Richard G. Mallory, at 19-26.

27/ Ehnot Testimony, at 20; Hearing Transcript at 119.

28/ However, Mr. Mallett reportedly elected to return to Federal Paper Board Co., and was to be replaced by Mr. Ehnot.

Federal's closing the plant voluntarily has no bearing on the proof of failing company. "Closed" is not synonomous with "failed."

> 13. "They [the Commission] held off for three and one-half weeks after Federal was forced to try to sell it to anyone for any price to decide to drop their holdup of a Federal and Lancaster merger."

If Federal were "forced" to sell Federal Glass, it was a position in which it placed itself. Federal had made little or no good faith efforts to locate a purchaser before it closed Federal Glass, and it is not clear how the voluntary closing of the glass division changed Federal's circumstances, if at all.

Furthermore, Federal never was in a position in which it had to accept "any price." Federal has always and still is maintaining that it would not sell Federal Glass for less than its liquidation value. There was, however, a substantial spread between liquidation value and the much higher price Lancaster was prepared to pay for acquiring additional market share and reducing competition.

Nevertheless, the Bureau acted immediately upon the closing to see if any measures could be taken to alleviate the burden that Federal's actions placed on the Federal Glass employees.

On February 2, 1979, the Bureau's staff proposed that Lancaster purchase Federal Glass, and operate the plant while the merits of the Complaint against the sale were litigated. Lancaster rejected this proposal, apparently not so sure of the merit of its position as appeared publicly.

Next, on February 7, 1979, the Bureau proposed a solution which would have resulted in a sale of Federal Glass within 30 days, if Federal were willing to proceed in good faith. The terms of that proposed settlement were:

1. Federal would reopen operations and put the employees back to work;

2. Federal would negotiate in good faith with prospective purchasers, at least two of which had already come forth, for a period of 30 days;

3. The Bureau would monitor negotiations;

4. If complaint counsel were satisfied that good faith efforts could not conclude in an offer to purchase the glass division at a price at least equivalent to that last offered to the employees, that would confirm the failing company defense, and pave the way for withdrawal of the Complaint and acquisition by Lancaster.

This proposal, too, was rejected.

During the entire period between the closing of the plant and the Bureau's motion to withdraw the Complaint, beginning on February 1, 1979, the day after the closing, the staff sought specific information from Federal which would show whether their claim that Federal Glass was a "failing company" was legitimate or not. Those efforts were vigorously contested by Federal, even to the extent of two days of hearings before the Administrative Law Judge on the staff's motion for compulsory process. The requested information never was obtained by the staff, which was forced to rely on secondary sources for information upon which to base its conclusions. The Commission recognized this difficulty in granting the Bureau's Motion to Dismiss. (Attachment F) One can only conclude that Federal was fully aware that the facts would not support its public allegations.

Most importantly, however, during the period between the closing of the plant and the Bureau's Motion to Dismiss, alternate purchasers were actively engaged in negotiations with Federal for the purchase of Federal Glass. Those purchasers planned to reopen the plant and operate it as a glassware manufacturing facility. It was not until the last of those purchasers formally withdrew from negotiations on February 23, 1979, that the Bureau felt justified in requesting a withdrawal of the Complaint, and permitting for the benefit of the Federal Glass employees, an acquisition which otherwise would be considered unlawful.

14. "In the meantime, one-half
of Federal's business is
gone--all to Anchor and Owens."

While it may be true that Federal has lost business during the period it has been closed, the Bureau has no means of measuring that loss. Nor has the Bureau any knowledge as to whom such business may have gone. The Bureau's staff has spoken with some former customers of Federal, which have indicated that all glassware manufacturers have approached them seeking business, including the smallest companies in the industry.

The potential loss of business may also have been lessened for two reasons. First, Federal Glass continued to sell glassware and meet pre-existing orders from its substantial inventory existing at the time of closing. 29/ Second, the first quarter of the year is the slowest in the glassware industry, thereby possibly diminishing the real impact on Federal Glass' business.

The reference to one-half of Federal Glass' business is probably derived from the consensus of opinion held in the industry that approximately one-half of Federal Glass' business, the most profitable portion, is virtually immune from permanent loss due to the quality of its product, in clarity and manufacture. 30/ It is this core of 50% which Lancaster apparently intends to reopen immediately, and from which it intends to expand vigorously. 31/

15. "The F.T.C. has awesome power
over industry, and this appears
to be in the hands of young,
inexperienced staff people who
don't seem to understand the
real business world."

The Commission's power over industry is far from awesome, as demonstrated by this very case. The Bureau had no power to prevent the closing of the Federal Glass plant, despite

---

29/ See, e.g., Statement of John Barnum, Esq., counsel for Federal Paper Board Co., Inc., Hearing of February 6-7, 1979.

30/ Joseph Ehnot testified himself as to the reputation of Federal Glass for high quality glassware. Ehnot Testimony, at 23-24.

31/ Letter of February 21, 1979, to Congressman Chalmers P. Wylie, from John B. Gerlach.

the lack of demonstrated financial necessity for such action. The staff could not even compel Federal to provide facts in support of its public claims of failure. The Commission's power stems directly from and is limited by the acts of Congress which charge the Commission with a duty to safeguard competition through enforcement of the law.

I respectfully submit that the Bureau's staff is experienced, dedicated, and thorough, and fully examined all aspects of this case before acting.

> 16. "Why, upon the complaint of the leaders in an industry (Anchor and Libbey), would the F.T.C. take an adversary position with two smaller companies who planned to merge to survive?"

As previously explained, the 1977 investigation was initiated when the FTC's staff discovered the proposed acquisition through public sources. The 1978 investigation was initiated in April, 1978, when Federal and Lancaster asked the FTC's staff to re-evaluate its opposition to the sale of Federal Glass to Lancaster.

The staff opposed the proposed acquisition because the relevant facts disclosed that the acquisition was anticompetitive, when interpreted in light of existing legal and historical precedent. Beyond self-serving declarations by Federal and Lancaster, moreover, the Bureau staff found no evidence that the proposed acquisition would result in any economies which might benefit consumers.

The staff's investigation disclosed that Federal Glass was profitable, and could be made into a very strong competitor if Federal were willing to make certain capital improvements to increase efficiency at the plant. This Federal was unwilling to do, having decided to invest in other industries instead, to the exclusion of Federal Glass.

Lancaster is in no danger of failure, and all indications are that Lancaster's subsidiary, Indiana Glass, was performing very well. In fact, Lancaster was apparently operating at full capacity [32] and had increased its market share from 7.1% to more than 9% between 1976 and 1977.

---

[32] Hoofstetter Testimony, p. 15. In fact, capacity had been increased by 15 tons per day in October 1976, and Lancaster has been increasing the number of items produced. Hoofstetter Testimony, p. 17 & 37. Lancaster had added 15-20 sales personnel during the period 1971-1976. Hoover Testimony, at 62.

17. "Why would the F.T.C. say that Federal's molds and equipment could be sold to #1 and #2 upon liquidation and not to Lancaster Colony, the fourth largest in the industry?"

The FTC staff has consistently taken the position that any sale of Federal Glass's molds and equipment to Anchor Hocking or Owens-Illinois would raise serious competitive problems. In fact, at page two of its Request for Expeditious Consideration of Respondent Federal Paper Board's Motion to Terminate and Complaint Counsel's Motion to Dismiss, the Bureau's staff argued that any consent decree (as proposed by Lancaster) that barred only Lancaster from buying Federal Glass's assets and not Anchor Hocking or Owens-Illinois, was not in the public interest because such a decree could increase the market share of those two firms in the glassware industry.

18. "Why would the F.T.C. say that Durand, a French manufacturer with more tableware business in the U.S. than Lancaster Colony would be allowed to buy Federal Glass?"

The FTC staff never concluded that an attempted purchase of Federal Glass by Durand should escape sanction under the antitrust laws. Instead, the staff's position has been that a purchase by Durand should be evaluated under the same antitrust standards that were applied to Lancaster's efforts to purchase Federal Glass. The staff sent a letter to the president of Federal on October 10, 1978, which stated:

> "Neither the Bureau of Competition nor the Commission has analyzed the competitive impact on the glassware industry of a sale of Federal Glass to Durand. Should such a sale be proposed, we would analyze it in the same fashion and under the same standards that have been used to examine the proposed sale to Lancaster Colony Corporation. Therefore, I urge you to notify us at as early a date as possible should such a sale become imminent, so that we may expedite our considerations."

19. "Why would the F.T.C. publish
a statement when Federal closed
that 'It did not make any difference,
Lancaster Colony would get all the
business anyway' when they knew
that Lancaster Colony did not even
have the capability to machine
blow glassware?"

The Bureau has never purported to know who would obtain Federal's glassware business if Federal Glass were closed. Congressman Devine's alleged quotation has incorrectly been given the status of a Commission position. At a pretrial conference in February 1979, the Bureau's staff alluded to the possibility that Lancaster would gain a competitive advantage because of its intimate knowledge of Federal Glass, and possible access to Federal's customer lists. This concern did not state the likelihood of Lancaster's obtaining Federal's business, but rather voiced a plausible reason for the Bureau's hesitance in agreeing to a simple ban on the sale of Federal Glass assets to Lancaster.

Such hesitance led the staff to oppose a motion by Federal to prohibit a sale of any assets of Federal Glass to Lancaster, on the grounds that such an order might not be in the public interest. Moreover, at page two of the Request for Expeditious Consideration, filed with the Commission, the staff specifically alluded to the danger that Federal's glassware business might be absorbed by Anchor Hocking and Owens-Illinois, should Lancaster be prohibited from acquiring any of the assets of Federal Glass.

20. "Why has it taken two years
for the F.T.C. to finally
admit that they made a wrong
decision?"

The Commission did not make a wrong decision in enforcing the antitrust laws against this acquisition. Neither did the Commission err in weighing the interests of the laid-off employees of Federal Glass more heavily than the benefits of prosecuting this case. Again, the acquisition of Federal Glass by Lancaster poses serious competitive problems and violates the antitrust laws. In this respect both the Bureau's position and the Commission's position are unchanged.

The Commission, at the Bureau staff's request, ordered that the Complaint be withdrawn solely because of the hardship to employees caused by Federal's voluntary business decision to close Federal Glass, and because the absence of a viable alternative purchaser posed the danger of liquidation and dispersal of the Federal Glass assets. Such liquidation might have resulted in permanent loss of those jobs.

I hope that this explication of facts of record has given you a proper context in which to view the actions of the Bureau, the Commission, and of the respondents, Federal Paper Board Company, Inc., and Lancaster Colony Corporation.

APPENDIX O.—ATTACHMENTS TO TESTIMONY OF LYNN CUTLER, RATH MEATPACKING, WATERLOO, IOWA

ATTACHMENT A

BLACK HAWK COUNTY ECONOMIC DEVELOPMENT COMMITTEE

Rath Report

June 6, 1978

Prepared by the
Iowa Northland Regional Economic Development Commission
and
Iowa Northland Regional Council of Governments

BLACK HAWK COUNTY
WATERLOO, IOWA 50703

BOARD OF SUPERVISORS

Room 201, COURT HOUSE
TELEPHONE (319) 291-2416

June 6, 1978

TO: Assistant Secretary Embry
Senator Dick Clark
Congressman Charles Grassley

FROM: Supervisor Lynn Cutler, Chair,
Black Hawk County
Economic Development Commission

RE: Rath Packing Company Situation.

Enclosed are materials we have gathered in our community in the last few weeks to attempt to assess the facts and impact of the potential Rath Packing Company loss.

We have met as a committee in the last few weeks to gather information about the labor force, the economic impact the company has on our community, and some of the possible sources of help available to us.

We are anxious to have you understand our situation and to help us identify the sources of federal assistance in HUD, Commerce and elsewhere.

We face a potential tragedy - one which would affect our community for years - and we are asking for your help.

This report is prepared for the Black Hawk County Economic Development Committee by the Iowa Northland Regional Economic Development Commission, a delegated authority group of the Iowa Northland Regional Council of Governments. The Commission is responsible for preparing economic studies for the Iowa Northland Region (state planning Region 7). Black Hawk County is the redevelopment area of this Economic Development District (organized under EDA guidelines) and has an organized economic development committee which prepares an annual program for inclusion into the Regional Overall Economic Development Program.

Black Hawk County received designation as an EDA redevelopment area in 1972 with the completion of an Overall Economic Development Program (OEDP). The County Committee prepared an Update of the OEDP in 1976 with the help of the Council of Governments staff. The Committee has since prepared an annual report and program update for FY 1978 and is in the process of preparing an updated report for the coming year.

The Committee has expressed concern in the OEDP updates about the continued decline in the fortunes of Rath Packing Company. The Company is the second largest employer in the county with a current employment of 1,843 persons. Employees at the Waterloo plant are not just residents of Waterloo, but include residents of many of the surrounding cities and counties.

Employment at other Rath facilities depend on the future of the Waterloo plant. The company employs 335 persons in Indiana, 175 in Texas, and 148 in California.

SURVEY OR RATH (WATERLOO) EMPLOYEES' HOME ADDRESSES
JUNE, 1978

Alta Vista	1
Aplington	3
Belle Plaine	1
Brandon	3
Buckingham	2
Cedar Falls	141
Cedar Rapids	1
Clarksville	3
Clutier	1
Dike	6
Dunkerton	9
Dewar	4
Denver	34
Dysart	6
Evansdale	108
Elk Run Hts	3
Fairbank	20
Fredericksburg	3
Frederika	3
Gilbertville	14
Gladbrook	1
Grundy Center	2
Holland	3
Hudson	17
Independence	21
Iowa Falls	1
Ionia	1
Janesville	12
Jesup	59
LaPorte City	30
Lamont	1
Lawler	1
Manchester	1
McIntire	1
Mt. Auburn	4
New Hampton	6
New Hartford	6
Oelwein	11
Oran	2
Parkersburg	10
Raymond	10
Readlyn	8
Reinbeck	4
Shell Rock	5
Stout	3
Sumner	2
Traer	8
Tripoli	11
Waterloo	1197
Washburn	21
Waverly	14
Wellsburg	2
Winthrop	1
Westgate	1
TOTAL	1843

EMPLOYMENT JUNE 1, 1978

Iowa	
Waterloo	1,843
Columbus Junction	274
Misc. Loc.	22
	2,139
Indiana	
Indianapolis	335
Texas	
Houston	40
San Antonio	108
Dallas	27
	175
California	
Los Angeles	145
San Francisco	3
	148

Waterloo Laid Off	312
Indianapolis Laid Off	110

Rath purchases approximately 35 percent of its $119 million livestock purchases from local producers. The loss of the company will have a detrimental affect on the local agricultural economy. Retail and service industries will face the loss of the company's $32 million local payroll and these industries will likely be forced to layoff employees.

According to figures calculated by the Waterloo Chamber of Commerce staff, the total number of jobs affected by a closing may be over 10,000. This represents, according to Chamber estimates, a loss of $30 million in effective buying income from the local economy.

The unemployment rate in Black Hawk County is estimated to jump to 8.1 percent of the labor force with the layoff of Rath workers. The Waterloo Chamber of Commerce estimates that the rate could reach near 15 percent with related layoffs in other industries.

Unemployment compensation payments to Rath workers will near $10 million for the 39-week eligibility period. The workers would then receive no compensation for the next 19 weeks, after this time they would again be eligible for compensation.

The average age of the Rath worker is in the 50's, and an above average percent of the workers are from minority groups. These workers would be hard to place in new jobs, and many will require retraining if they are to become employable in the local job market.

The Black Hawk County Economic Development Committee became concerned at the possibility of the closing of Rath and appointed a Rath Study Committee to

MISCELLANEOUS

Waterloo Payroll 1977	**$32,000,000**
Waterloo Livestock Purchases	**$119,000,000**

Waterloo Chamber of Commerce
229 West 5th Street, • P. O. Box 749, • Waterloo, Iowa 50704 • Phone (319) 233-8431

RATH STATISTICS

Total Rath Employees - 1,900

Total Jobs Affected - 10,545

Rath People Affected (Family) - 5,130

Average House Effective Buying Income (SM&M) $30,827,500
After taxes

10,545 Affected - $171,092,625 a year
329,024 a week

90 families eligible at $12,450 a month for 6.5 months
or $80,925 or $413 a day

Total unemployment checks would equal $9,855,300 for the
39 weeks, at
$252,700 a week or
36,100 a day or
50,540 a work day

After the 39 weeks are over the unemployment checks would stop and after 19 more weeks the unemployed would be eligible for more compensation

Unemployment percentage would be 8.1 percent immediately - Ripple Effect would be approximately 15 percent overall

BUSINESS DEVELOPMENT COUNCIL
6/1/78

RATH SITUATION: Additional Statistics

1500 - bargaining unit - Waterloo

100 - office unit

30% - women

10% - black

51.7 - years , average age in plant

85% - of the Waterloo plant force lives in Black Hawk County

RATH STUDY COMMITTEE

Lewie Anderson	AMC International Union
Connie Birmingham	Senator Dick Clark's Office
Pat Callan	Job Service of Iowa
Pete Conroy	Congressman Charles Grassley's Office
Hugh Copeland	INRCOG Staff
Galen Cox	Job Service of Iowa
Lynn Cutler	Black Hawk County Board of Supervisors
William Davidson	Local 431, Davenport
Jerry Franke	Waterloo Planning Office
Mary Hafke	Black Hawk County CETA
Pat Hipple	Waterloo Chamber of Commerce
Rob Hubler	Senator Dick Clark's Office
Emmett McGuire	Rath Packing Company
Jack Niemann	Chairman, Economic Development Commission
Thom Roberts	Waterloo Chamber of Commerce
Leo Rooff	Mayor of Waterloo
Sam Scherf	Cedar Falls Chamber of Commerce
Charles Soladay	Rath Packing Company
Lyle Taylor	Local P46, Waterloo
James Thele	INRCOG Staff
Henry Wulff	Congressman Charles Grassley's Office

examine the problem. The Study Committee is composed of Rath Union representatives, Rath management people, Job Service of Iowa staff, Manpower Program staff, Waterloo and Cedar Falls Chamber of Commerce staff, the Chairman of the Iowa Northland Regional Economic Development Commission, Senator Clark's staff, Congressman Grassley's staff, and local elected officials.

The study committee approached the problem from the viewpoint that Rath Packing Company, with financial assistance, will continue in business. The committee also discussed the steps to be taken if help is unavailable.

Rath management provided information to the committee on the company's financial situation. Management personnel indicated that the six month extension on payment of the principal of the current EDA loan will allow the company to continue operation, but that the company needs a large sum of money for capital and operations improvements to prevent the problem from reoccurring.

Union officials presented the workers position on the problem and stated that working people have the most to lose if the company fails. The union has been assisting the company to increase production and has given other assistance to the company.

The Rath Study Committee examined a number of sources for funding for the company. Federal sources included the Economic Development Administration's Title IX Program, Department of Housing and Urban Development's Urban Development Action Grant program, and the President's proposed urban aid package. Local sources of funds for matching a federal commitment were discussed and the committee is confident that local funds are available. Local sources include the sale of bonds to individuals by a non-profit corporation and the use of industrial revenue bonds.

Rath management prepared a list of capital and operating improvements which are designed to provide a relatively fast pay back. The company believes that a potential expenditure of $10.2 million will realize a potential annunal profit improvement of $5.7 million. A proposal for these improvements will be included in the County's Overall Economic Development Program for possible funding. The possibility of a new facility was discussed, however, the cost would likely be too great for a possibility of funding.

The proposed capital and operating improvements do not represent an in-depth analysis, but the company believes that the figures are accurate to the best of its knowledge. On this basis, the study committee recommended the improvements to the Black Hawk County Economic Development Committee and the Iowa Northland Regional Economic Development Commission for inclusion into the OEDP. The Economic Development Administration has been requested to prepare a feasibility study for improvements to the company. The results of this study will provide additional guidance for the capital and operating needs which are necessary to make the Waterloo Rath plant profitable.

Local industry, commerce, labor, and government have shown a desire to maintain Rath Packing in Waterloo. The Black Hawk County Economic Development Committee is confident that with federal and local assistance Rath will continue to operate.

THE RATH PACKING COMPANY

FINANCING NEEDS FOR PROFIT IMPROVEMENT OPPORTUNITIES

Following are some examples of opportunities which represent relatively fast pay-back situations. In most instances, there has not been an in-depth analysis but the study is accurate to the best of our current knowledge:

	Potential Expenditure	Potential Annual Profit Improvement
1. Waste Water Treatment. Our projected cost for the anticipated City waste treatment facility ranges from $400,000 to $800,000 per year. Installation of a pre-treatment process would cost $500,000 and would result in our charge being at the $400,000 level rather than the higher figure.	$ 500,000	$ 400,000
2. Smoked Meat/Sliced Bacon Layout. A new, modern, efficient one-floor system capable of producing 1,000,000 pounds of bellies, 500,000 pounds of boneless hams and related items would cost $4,500,000. This would improve yields and cost, making us more competitive to an estimate of 5¢ per pound, or about $1,600,000 on an annual basis.	4,500,000	1,600,000
3. Relocate ham canning to a one-floor operation: $400,000. This would allow improved product flow, line efficiencies, and include $100,000 for the new closing equipment compatible with plastic cans. As tin continues to skyrocket in cost, the change to plastic becomes mandatory. This could well mean 7 to 10 cents per pound reduced costs, or about $1,000,000 annually.	400,000	1,000,000
4. Relocate beef fabricating: $175,000. Improve efficiency, realize a box beef operation with a less-than-one-year pay-back.	175,000	175,000
5. Dry Sausage lay-out for $360,000. This is primarily equipment which would result in substantial improvement in our competitive situation.	360,000	Not determined
6. Wiener, fresh sausage, and other sliced meat opportunities. They are currently spread over a six-floor area. To replace needed equipment and to relocate the entire operation to one floor would probably cost $750,000 and no estimate of the pay-back has been made at this time.	750,000	Not determined

In the area of sales and marketing, the media cost skyrocketed the last few years. Our advertising budget probably doesn't even cover maintenance of our image, much less force new product distribution.

Products recently introduced or about to be introduced which offer considerable profit opportunity, include the Rathskeller line of premium sausage items, Hickorylean bacon, which is a fabricated bacon similar to Swift's "Sizzlelean," guaranteed

THE BATH PACKING COMPANY
FINANCING NEEDS FOR PROFIT IMPROVEMENT OPPORTUNITIES

	Potential Expenditure	Potential Annual Profit Improvement
lean canned hams, which compete favorably with the import canned hams which have taken over 50% of the American canned ham market. Black Hawk boneless hams which are capturing a larger and larger share, and a 1-lb. smorgasbord sliced meat pack which represents a potential profitable volume business. Approximately $1,000,000 is needed to promote these products. The estimated increase in sales because of these products could produce $2,500,000 of profit margins.	$1,000,000	$2,500,000
7b. We need to expand and develop markets closer to the Waterloo facility. These markets are Chicago, Milwaukee, Minneapolis, Kansas City, and St. Louis. These markets can be serviced from the Waterloo facility overnight. Approximately $1,000,000 is needed for this market expansion program.	1,000,000	Not determined
7c. The rapid growth of the food service industry presents a dramatic opportunity. With an additional $1,500,000, we could enter the market on a national scale. Capital to be used to set up a central distribution center to receive product from the Waterloo plant, for marketing and promotional dollars and investment to hire qualified food service personnel. We project an estimated increase in annual sales at the end of the first year of 30 million pounds annually.	1,500,000	Not determined
8. A more sound financial position would allow us to attract some key personnel. We need an expert in physical distribution as transportation is now our second biggest expenditure and its cost is rising. We need more direct sales personnel to handle large accounts by phone. A professional manager of planning and budget would probably pay big dividends.	Not determined	Not determined
9. Although we have delayed pension fund contributions in the past, that obligation does not go away. The pension benefits are being paid at a current rate of approximately [illegible],000,000 per year and that has been increasing some [illegible],000 per year. This cannot be ignored indefinitely.	Not determined	Not applicable
Any borrowed funds received but not applied to the foregoing items could be used to pay Talcott down and reduce the expense of an interest rate of 5% over prime.	Not determined	Not determined
	$10,185,000	$5,675,000

24, 1976

PROJECTED ADDITIONAL STAFFING

1. Assume second shift 480/hr Hog slaughter & cutting operation	270
2. Assume two-shift 3# & 5# Plastic Ham Canning Operation	59

WITHHOLDING AND SOCIAL SECURITY TAXES PAID
CALENDAR 1977

	Income Withholding		Social Security		
	State	Federal	Employees F.I.C.A.	Employers F.I.C.A.	Total
Iowa	1,434,297	6,263,238	2,117,280	2,117,280	11,932,095
Indiana	152,484	1,242,338	423,760	423,760	2,242,342
California	77,185	396,815	137,530	137,530	749,060
Texas	None	713,736	234,161	234,161	1,182,058
TOTAL	1,663,966	8,616,127	2,912,731	2,912,731	16,105,555

REAL ESTATE & PERSONAL PROPERTY TAXES PAID 1977

Black Hawk County (Waterloo)	$521,200
Louisa County (Columbus Junction)	31,962
Indianapolis	129,765
Los Angeles	66,757

ATTACHMENT B

January 18, 1980

Official: Pre-April Rath vote unlikely

By STEVE SALATO
Courier Staff Writer

April would be the earliest that stockholders of Rath Packing Co. would be able to vote on an employee stock purchase plan, a company official says.

The plan, which calls for Rath's union employees to purchase controlling interest in the company in an effort to keep the financially troubled firm afloat, must be approved by the Securities and Exchange Commission before stockholders would vote on it.

CHARLES SOLADAY, Rath's vice president of finance and administration, said the SEC has been presented with preliminary information concerning a voting trust and the purchase plan, but has not yet received a registration statement outlining details of the company's financial conditions and what the employee purchase proposal involves.

Soladay described the preliminary information that has been sent to the SEC as a summary of what is proposed.

Preparing a final draft has been a time-consuming and complicated task, Soladay said. "Once everybody sees it, they'll see why. This voting trust is very complicated," he said.

Soladay added, "We know they (SEC commissioners) want information that was in our annual report, and we know they need a five-year summary of operations."

He said it is optimistic to think that the final draft can be completed by Feb. 1, adding that it would most likely be sometime later in February before a final statement can be sent to the SEC.

Once the final statement is sent to the agency, Soladay said, it probably would take two to three weeks for it to review the plan and ask questions about it.

Assuming the SEC approved the plan, Soladay said, a stockholders' meeting could not be called for at least another 30 days.

Stockholders must be given time to review the plan and send in their proxies, he said.

GIVEN THE timetable for completing a final draft, having it approved by the SEC and letting stockholders study it, Soladay said, "the first part of April is the earliest I can see for a stockholders meeting."

Approval of an employee stock purchase plan is among the requirements before a $4.63 million grant for Rath from the Department of Housing and Urban Development receives final approval.

The plan calls for employees to receive a portion of their weekly wages in Rath common stock over about a 2½-year period, until an additional 1.1 million shares of authorized but unissued stock is distributed.

When all the stock is distributed to employees, they would own approximately 60 percent of the company's total common stock expected to be outstanding at the time.

Revenue from the stock purchase plan would be used by Rath as part of the $20.2 million the company must invest at its Waterloo plant to qualify for the $4.63 million HUD grant, according to the proposed contract the agency has sent to local officials.

Part of the $20.2 million also would come from deferred employee benefits and from a $3 million Economic Development Administration grant previously loaned to Rath by the Black Hawk County Economic Development Committee.

The stipulation regarding deferred benefits has prompted a $3 million lawsuit, filed by eight Rath employees who contend that a withholding of their benefits in this case is illegal.

The case is being handled in U.S. District Court in Cedar Rapids.

SOLADAY SAID the company would prefer that the suit be settled before a stockholders vote.

If it is not settled before then, the suit could have a negative impact on investors as they decide whether to approve the stock purchase plan, Soladay said.

The suit has been filed against Local P-46 of the United Food and Commercial Workers International Union; the local's president, Lyle Taylor; and the international union.

12-16-79

SEC will be getting Rath stock plan soon

A plan outlining the details for a vote by stockholders of the Rath Packing Co. on an employee stock purchase proposal soon will be sent to the federal government.

The plan, to be sent to the Securities and Exchange Commission (SEC), must be approved by the agency before stockholders can vote on a proposal to allow Rath employees to purchase controlling interest in the company—a measure intended to help keep the financially troubled firm afloat.

In September, Rath announced that it had reached "an agreement in principle" with union employees on a plan for the workers to purchase the majority of stock in the company.

The "agreement in principle" was made with Locals 46, 1278 and 431 of the United Food and Commercial Workers Union, which represents Rath employees in Waterloo and Columbus Junction.

APPROVAL OF an employee stock purchase plan is among the requirements that must be fulfilled before a $4.63 million federal grant to Rath receives final approval. The money would come through an Urban Development Action Grant from the Department of Housing and Urban Development.

Word that a plan calling for the stockholders' vote has been prepared and would be sent to the SEC came after a Friday afternoon meeting of a subcommittee of the Black Hawk County Economic Development Committee, which has been involved in efforts to get financial aid for Rath.

"It's the call for the vote, and it outlines all the elements in the vote," said Lynn Cutler, president of the committee, in reference to the plan.

She said she did not know how long it would take the SEC to act on the plan or when stockholders might be able to vote on the employee stock purchase proposal.

The plan calls for employees to receive a portion of their weekly wages in Rath common stock over about 2½ years, until an additional 1.1 million shares of authorized but unissued stock is distributed.

When all the stock is distributed to employees, they would own approximately 60 percent of the company's total common stock expected to be outstanding at the time.

Revenue from the stock purchase plan would be used by Rath as part of the $20.2 million the company must invest at its Waterloo plant to qualify for the $4.63 million HUD grant, according to the proposed contract that HUD has sent to local officials.

THE $20.2 MILLION also would come from deferred employee benefits and from a $3 million Economic Development Administration grant previously loaned to Rath by the county Economic Development Committee.

Attorney Bill Smith, handling legal matters for the city concerning the $4.63 million grant, has said his two main concerns in getting the money are with a stock purchase agreement between Rath and Local P-46 and with the deferred employee benefits stipulated by HUD.

The stipulation regarding deferred benefits has prompted a $9 million lawsuit, filed by eight Rath employees who contend that a withholding of their benefits in this case is illegal.

The case is being handled in U.S. District Court in Cedar Rapids.

Thurs., Nov. 15, 1979 Waterloo Courier 5

Rath reports 'substantial' fourth quarter improvement

The Rath Packing Co. announced Thursday that operating results for the company's fourth quarter of 1979 were "substantially improved" over the same quarter of 1978.

Emmet A. McGuire, the company's president and chief executive officer, said the firm had net earnings of $1.086 million, or 84 cents per share, for the 13 weeks ended Sept. 29. That amount compares with a net loss of $2.486 million, or $2.09 per share, for the same quarter last year.

Net sales were $81.128 million this quarter and $71.835 million a year ago.

THE COMPANY also reported a net loss of $1.685 million, or $1.25 per share, for the year ended Sept. 29, compared to a net loss of $6.441 million, or $5.40 per share, for the preceding year.

Net sales were $316.885 million for the 1979 fiscal year and $320.988 million for the 1978 fiscal year.

"The trend to higher margins on sales and on hog slaughter operations, which began earlier this year, has continued through this quarter," McGuire said. "Compared with the same quarter in 1978, a significantly larger supply of hogs was available, and, accordingly, hog purchase prices were lower.

"Related selling prices for pork products also declined. The favorable relationship of selling prices for pork to beef strengthened customer demand for pork."

THE INCREASE in net sales in the current quarter is attributed principally to a 28 percent increase in pounds of products sold, which more than offset the effect of lower average selling prices, Rath said.

Net earnings for the fourth quarter of 1979 include a credit of $300,000 for an estimated refund in connection with the settlement of a class action litigation involving certain manufacturers of folding cartons, the company said.

"We expect that sales and operating levels will continue to be favorable for the year ahead, particularly during the first quarter," McGuire said.

Stockholders must OK stock purchase

July 10, 1979

Grant to assist Rath approved

By BOB CASE
Courier Staff Writer

Tentative approval has been given for a $[illegible] federal grant to the City of Waterloo to assist the financially troubled Rath Packing Co.

Final approval is contingent on Rath stockholders going along with an employee stock purchase plan.

Mayor Leo Rooff received word of the tentative approval Tuesday from the offices of Sen. John Culver, D-Cedar Rapids, and Third District Congressman Charles Grassley, R-New Hartford.

A spokesman for Culver said the senator had been advised by the White House the Department of Housing and Urban Development approved the Urban Development Action grant.

OF THE total amount of the grant, Rooff said $[illegible] will be loaned to Rath for capital improvements at the company's Waterloo plant.

The grant is $[illegible] more than had been requested.

Emmett McGuire, Rath president, said Tuesday a meeting of stockholders to consider the employee stock purchase plan will be called as promptly as possible.

Before the plan can be submitted to stockholders, McGuire explained it must be approved by the federal Securities and Exchange Commission, and he said that could take two to three months.

He said the Rath Board of Directors will recommend approval of the plan by stockholders.

According to Rooff, the grant is expected to generate $11.6 million in private capital, including $[illegible] million from the sale of stock to employees and deferred employee pay raises and benefits.

"Approval of the grant is a culmination of the cooperative efforts of many people and organizations," Rooff said.

ACCORDING TO the mayor, it will permit the meat packing company to "improve its facilities, making it a more viable operation."

The amount of the grant retained by the city ($[illegible]) will be used for contingencies and administrative expenses, according to Community Development Director Dale Mercer.

According to Culver's office, HUD estimates the grant "will save 1,[illegible] jobs at the Waterloo plant and other Rath facilities."

Black Hawk County Supervisor Lynn Cutler, however, said Tuesday the money should be loaned through the county Economic Development Committee.

Mrs. Cutler is chairman of the non-profit committee which was primarily set up to channel a $[illegible] million federal Economic Development Administration grant to Rath for raw materials and to meet payrolls.

After a telephone conversation with Rooff Tuesday, she said he told her he would reconsider loaning the money through WIDA.

Mrs. Cutler said the economic development committee is a broader based organization than WIDA.

And, she added, the committee was mentioned in the UDAG grant application as the conduit for the money.

For the long run, he said the city will have two options when the loan from the UDAG grant is repaid by the firm—either to reloan it to Rath or to use the money for public improvements.

Last October, the $[illegible] million grant through the federal Economic Development Administration was secured to loan the firm.

The $[illegible] to be loaned to the company from the latest grant will be used for capital provements in the following areas:

Hog cooler spray system, $[illegible]; relocation of ham canning, $[illegible]; dry sausage, $440,000; fresh sausage, $[illegible]; smoked meat-sliced bacon, $[illegible]; packaged shortening, $[illegible]; [illegible] beef fabrication and boxed beef, $175,000; edible rendering system, $[illegible]; and kill and cut improvements, $[illegible].

October 11, 1978

$3 million Rath grant approved

By PAT O'CONNER
Assistant City Editor

An official of the federal Economic Development Administration will deliver a check for $3 million to Waterloo Monday to help the financially beleaguered Rath Packing Co. purchase hogs.

Robert Hall, assistant secretary in the Commerce Department which oversees the EDA, notified Iowa Sen. Dick Clark's Washington office of the approval of the grant at mid-afternoon Wednesday.

Clark's office said George Mueller, another EDA official, will arrive in Waterloo Monday to deliver the grant to the county's Economic Development Committee Inc., a non-profit corporation which would then loan the money to Rath at 6 percent interest.

THE SHORT-TERM working capital loan, according to Rath officials, would help the company boost production and inventories in preparation for the profit-making holiday season.

Company officials have said they may be able to return some of the more than 400 workers laid off in the past two weeks once the grant comes through.

Rath will begin interest payments on the loan within 45 days and totally repay it within 90 to 120 days.

When the loan is repaid to the corporation, formed last week to seek the grant, the corporation would release the money to the company to begin implementation of plant and operation improvements suggested by a consulting firm.

SEN. CLARK commented Wednesday afternoon that word of the grant for Rath "is great news for Waterloo and I'm extremely pleased that EDA has demonstrated confidence in the city's ability to turn around the present difficult situation.

"This action is a tribute to the cooperation between Rath and its employees, along with local, state and federal officials."

It had been estimated that if the company were to fail, layoff of the [illegible] Rath employees in the Waterloo would result in an annual payroll loss of [illegible] million, a rise in the county's unemployment rate to [illegible] percent, and a loss of about [illegible] million of livestock purchased from area producers.

The loan application provides that [illegible] of the $3 million will be awarded to the Iowa Northland Regional Council of Governments (INRCOG) for staff work and other expenses related to the effort to save Rath.

October 2, 1978

Community Development panel completes Rath money application

[illegible]

An application for a $4.65 million federal grant for changes at the Rath Packing Company's Waterloo plant has been completed by the city's Community Development staff.

Community Development Director Dale Mercer said Thursday morning that the city staff completed the draft copy of the application for Urban Development Action Grant (UDAG) funds through the Department of Housing and Urban Development (HUD) Wednesday.

The application must go through an Oct. 18 public hearing before being presented to the council for action later this month.

Mercer said $4.21 million will go toward changes in the Rath plant recommended in a Manhattan, Kan., consulting firm's report released in September. Another $120,000 will be for administrative costs, such as legal fees and any other needed studies, while $300,000 will go into a contingency fund.

ALTHOUGH THE city will be awarded a grant, the money will be loaned to Rath through a third part—possibly the Waterloo Industrial Development Association or the Black Hawk County Economic Development Committee Inc. The county group was incorporated Wednesday to seek a $3 million Economic Development Administration (EDA) grant to meet immediate operational needs at Rath.

Mercer announced the figures for the city's grant application during a meeting of the A-95 Committee of the Iowa Northland Regional Council of Governments (INRCOG).

The A-95 Committee supported both the UDAG and EDA applications.

Jim Thele, an INRCOG planner, is in Denver, Colo., working with a special EDA team to complete the $3 million grant application by Friday. Upon completion it will be forwarded to Washington, D.C., for final approval.

County Supervisor Lynn Cutler, who was elected earlier this week as president of the new corporation, will fly to Denver Friday to sign the grant application. Community leaders from throughout the county Monday decided to form the new corporation to seek the federal grant after they were unable to obtain a loan for Rath from local lending institutions.

THE NONPROFIT corporation had to be formed because Iowa governments are not allowed to loan money to a company. The new corporation will lend the money to Rath with interest. Rath officials have estimated it will be repaid by January after which it can be re-loaned for future improvements.

Community leaders have expressed hope the grant can be obtained within the next few weeks so Rath can boost production and inventories for the holiday season.

Mercer said the city may not be able to spend the UDAG funds until early 1979.

A public hearing will be conducted on the UDAG application at 7 p.m. Oct. 18 in City Hall. Deadline for submitting the application to HUD is Oct. 31.

Mercer said it may take two months after submission to learn whether the city is awarded the UDAG grant. After that, it could be as much as three to four months before contracts are drawn up and the money can be spent.

The city was awarded a $2.1 million UDAG urban development grant in July and city officials are still ironing out contract details with HUD. Mercer said he hoped that contract negotiations can be quicker if the city is awarded the UDAG funds for Rath.

WATERLOO WILL be competing with more than 300 cities with over 50,000 population for about $200 million in UDAG funds, Mercer said.

Mercer said details over the terms of the loan or repayment schedule if the city is awarded the UDAG funds haven't been worked out yet.

Local matching funds for the $4.65 million application will come from the $3 million EDA loan and about $50,000 in federal community development funds.

The $4.21 million for plant improvement will be divided as follows:

—$375,000 to relocate hog casing to one floor.

—$1.25 million to modernize meat and bacon operations.

—$425,000 to modernize dry sausage operations.

—$1.8 million to modernize wiener operations.

—$265,000 for manning schedules.

—$245,000 to relocate beef fabrication.

—$20,000 for hog buying stations.

—$50,000 to sell idle equipment.

Moves under way to seek funds for Rath

[illegible]

October 3, 1978

tinued

MRS. CUTLER said EDA officials have made the loan a "high priority."

Jim Thele, a planner with the Iowa Northland Regional Council of Governments, traveled Tuesday to the EDA regional office in Denver, Colo., to prepare an application for the $3 million loan. A special team at the regional office has been assigned to work on the application.

Mrs. Cutler said that federal officials have said the $3 million will count as the local matching funds for the $4.5 million Urban Development Action Grant (UDAG) funds.

THE COUNCIL Monday night authorized Mercer to prepare the UDAG application and set a public hearing for Oct. 16 on the application. After the hearing, the council will consider authorizing Mercer to file the application.

Mercer said he plans to file the application by Oct. 28. Deadline for the UDAG application is Oct. 31.

Mercer said he didn't yet have exact figures but he said details should be available by the end of this week. The $4.5 million suggested in the consultant's report for improvements to the plant is the best estimate, he said.

UDAG funds would go to the city which would loan them to Rath.

Jim Lindsey, assistant Community Development director, said the city would have to funnel the money to Rath through a third party because of the state law preventing loans by governments to private businesses.

Lindsey said this would be similar to the action the city is taking in funneling the $3.3 million UDAG funds awarded to Waterloo in July through the Waterloo Industrial Development Association to developers.

IN OTHER developments:

—The county Board of Supervisors, meeting in special session Tuesday morning, adopted a resolution recognizing the new corporation as being representative of the economic interests of the county. Assistant County Attorney Peter Burk said this should help in the application for the $3 million.

—The supervisors voted to send a letter in support of the city's UDAG application.

—At least 375 Rath workers may have been laid off last Friday instead of the announced 380. Lyle Tayler, president of Meat Cutters Local P-46, said 375 workers signed up for unemployment benefits Monday at the union's headquarters. Sunday said the difference in the figures may be attributable to normal operations at the plant. He said in a given week a certain number of people are laid off and hired as part of normal operations. They may be in addition to the 380 laid off as part of the cost-cutting measure, he said.

ATTACHMENT C

BOARD OF DIRECTORS OF THE
BLACK HAWK COUNTY ECONOMIC DEVELOPMENT COMMITTEE, INC.
1980

Term Expires January 1981

Robert Abbas - Cedar Falls Community Development Department
George Bennett - Hawkeye Institute of Technology
Rev. Percy Burt - Minister
Patrick Callan - Job Service of Iowa
Galen Cox - Job Service of Iowa
Norma Cunningham - Business and Professional Womens Club
Lynn Cutler - Black Hawk County Board of Supervisors
Norm Faucher - Real Estate Appraisal
Jerold Franke - Waterloo Plan and Program Department
Lee Miller - University of Northern Iowa
Frank Mollenhoff - Goodwill Industries of Northeast Iowa, Inc.
Dave Neil - Local 838 United Auto Workers
Sam Scherf - Cedar Falls Chamber of Commerce
George Sieglaff, Jr. - Black Hawk County Farm Bureau
William Slade - John Deere Waterloo Tractor Works
Charles Soladay - Rath Packing Company
Marguerite Tredwell - Waterloo Chamber of Commerce

Term Expires January 1982

Robert Aldrich - Mayor of Evansdale
Elaine Anderson - Black Hawk County Bankers Association
Earl Everett - Black Community Advancement Association
Jerome Fischels - Mayor of Gilbertville
Rachel Fulton - League of Women Voters
Jeri Jenner - Junior League
Paul Larsen - Black Hawk County Union Council
Darrel Loveless - Mayor of La Porte City
David Mazur - Black Hawk County Comprehensive Employment Training Program
Dale Mercer - Waterloo Community Development Department
Robert McLaury - Evansdale Community Development Board
Darrel Porter - Cedar Falls Industrial Development Association
Leo Rooff - Mayor of Waterloo
Reynold Schmitz - Mayor of Raymond
Doug Sharp - Mayor of Cedar Falls
Gene Taylor - Mayor of Hudson
Lyle Taylor - Local P-46 Meatcutters Union
Walter Wheaton - Iowa Northland Regional Council of Governments

Officers and Executive Committee

Lynn Cutler - President
Dale Mercer - Vice President
Marguerite Tredwell - Secretary-Treasurer
Leo Rooff - Member of Executive Committee
Gene Taylor - Member of Executive Committee

ATTACHMENT D

MEETING SUMMARIES
BLACK HAWK COUNTY ECONOMIC DEVELOPMENT COMMITTEE

May 12, 1978

The Committee reviewed the past year's economic development program. Pat Callan presented data on employment in the county. James Thele reported on the development of the Regional OEDP and on the Committee's role in the regional organization. Lynn Cutler was elected Chairperson for the coming year. The situation at Rath Packing Company was discussed and a study committee would be organized to develop a strategy to prevent the closing or cushion the loss to the workers and the community.

May 23 and June 2, 1978 (Private Meetings)

A Rath Study Sub-Committee composed of local and state social services agencies, the employment service, chamber of commerce, the congressional staffs, Rath management and labor, and members of the Committee met to discuss possible solutions to the problem. Reports from social service agencies and the employment service indicated that they were capable of providing short-term assistance to the workers with a minimum of delay. Reemployment for the Rath workers did not look promising, based on the results of an informal survey of area employers. Rath management presented information on the Company's needs. The Union stated its position and outlined how labor has contributed in the past. It was decided to approach the federal government for assistance for a long-range solution to the problem. HUD funds could be used for capital items only, and EDA funds could be used for capital and operating funds.

June 17, 1978

Senator Clark met with the Committee and toured the Rath plant. Clark announced that a technical assistance grant from EDA would be made to study the problem and outline a solution.

June 23, 1978

The County OEDP was presented to the Committee. The OEDP listed as its top projects the technical assistance study of Rath and capital and operating assistance for Rath or economic adjustment assistance. The Committee discussed the Rath situation and the proposed technical assistance grant. A report was given on discussions in Washington regarding federal assistance. A report was made on the air quality non-attainment status of the county.

July 7, 1978

The Committee heard a report from a sub-committee composed of Rath management, the Union, the INRCOG Chairman, Mayor Rooff, and Chairperson Cutler on their recommendations on the consulting firms for the EDA technical assistance grant. Two companies submitted bids: Development Planning and Research Associates and W.A. Golomski and Associates. The sub-committee recommended DPRA and the Committee concurred in the recommendation to INRCOG to hire that firm for the grant. Lynn Cutler reported on discussions with HUD officials and announced that Robert Embry of HUD would tour the Rath facility.

August 11, 1978

An interim report was made by representatives of the DPRA/Globe Consultants on their study of the Rath operations and facilities. They reported that the initial phase of the study was completed and that they were in the analysis phase after which the alternative solutions would be outlined. One of the preliminary findings was that Rath will need a new plant within a few years. Changes were discussed in the plant, marketing, and in the company information system.

September 8, 1978

The draft final report by the DPRA/Globe consultants was presented to the Committee and time was allowed for discussion.

September 27, 1978

Lynn Cutler reported on her meetings with EDA officials in Washington, and Linda Marshall, of the Waterloo Community Development staff, stated that the city would apply for a UDAG grant in October. Approval was given to request INRCOG to apply for $9,999 from EDA to extend the DPRA/Globe contract for follow-up work. The Committee would apply for an EDA grant of approximately $25,000 to provide staff to coordinate the efforts by Rath management, the Union, the city, the Committee, and the federal agencies in implementing a long-term solution to Rath's problems.

The Rath Packing Company Annual Report 1979

Principal Business Activities of The Rath Packing Company

Rath sells processed meat products derived from raw materials obtained from its hog slaughter operations and from outside purchases. It also sells fresh cuts of pork and other products generated from its slaughter operations. Beef carcasses and cuts and other food items are purchased for further processing and sale or for resale. Both pork and beef are processed by the company for distribution in consumer packages, principally as sliced bacon, canned and smoked hams, fresh sausage (including sliced luncheon meats and wieners) and dry sausage.

Most of the company's products are sold nationwide by Rath salesmen to chain food stores and to cooperative and voluntary buying groups of independent retail food stores and, in certain regions, to hotels, restaurants and institutions. In addition, selected products are sold on a carlot basis through brokers.

Financial Summary

	Fiscal year ended	
	September 29, 1979	September 30, 1978
Net sales	**$318,895,000**	$330,688,000
Net loss	**(1,485,000)**	(6,441,000)
Per share	**(1.25)**	(5.40)
Additions to property, plant and equipment	**624,000**	662,000
Depreciation and amortization	**1,842,000**	2,051,000
Working capital	**7,862,000**	4,174,000
Ratio of current assets to current liabilities	**1.24 to 1**	1.14 to 1
Mortgage note payable (noncurrent portion only)	**2,788,000**	3,643,000
Obligations under capital leases (noncurrent portion only)	**6,423,000**	7,156,000
Stockholders' equity (deficit)	**(1,066,000)**	419,000
Per share	**(.89)**	.35
Average number of shares outstanding	**1,192,750**	1,192,750
Number of stockholders	**3,030**	3,177
Number of employees	**2,953**	2,241

Directors

Charles F. Swisher*
Chairman of the Board

Arthur J. Frey**
Retired, Former Vice President
Continental Illinois National Bank
and Trust Company of Chicago

John F. Lambert
Senior Vice President of Sales
and Marketing

Emmet A. McGuire
President and Chief Executive Officer,

Howard G. Rath, Jr.**
Partner, Macdonald, Halsted &
Laybourne, Attorneys
Los Angeles, California

Jack Thomas
Retired, Former Executive
Vice President of Operations

*Partner, Swisher & Cohrt
Attorneys
Waterloo, Iowa

**Member of audit committee

Officers

Emmet A. McGuire
President and Chief Executive Officer

John F. Lambert
Senior Vice President of
Sales and Marketing

John R. DeGroot
Vice President, National Sales Manager,
Retail Sales Division

Ivan E. Pihl
Vice President and Operations Manager
Waterloo and Columbus Junction,
Iowa, Plants

Charles W. Sciaday
Vice President of Finance
and Administration and Treasurer

Robert D. Bradshaw
Controller and Assistant Secretary

John H. Stevens
Secretary and Director of Employee
Relations

Transfer Agent and Registrar
Continental Illinois National Bank and
Trust Company of Chicago

Stock Trading
American Stock Exchange (Traded)
Midwest Stock Exchange (Listed)

General Counsel
Charles F. Swisher*

Independent Accountants
Price Waterhouse & Co.

*Partner, Swisher & Cohrt
Attorneys
Waterloo, Iowa

To Our Stockholders

Substantial improvements in operating results for the third and fourth quarters of the 1979 fiscal year, for which net earnings were reported, were the major reasons for a substantially reduced net loss for the full year. For the year ended September 29, 1979, the company had a net loss of $1,485,000, or $1.25 per share. This compares with a net loss of $6,441,030, or $5.40 per share, for the preceding year. Net sales were $316,895,000 for the 1979 fiscal year and $330,688,000 for the 1978 fiscal year.

The decrease in net sales in 1979 is accounted for principally by a lower number of pounds of products sold. Sales volume increased in the second half of the year but not enough to offset the reduced volume in the first half. Higher margins on sales and from hog slaughter operations were realized because of a significantly larger supply of hogs, resulting in lower hog purchase prices and a favorable relationship of selling prices for pork to higher priced beef. Delivery, selling, and administrative expenses were also significantly lower in 1979, after allowing for inflation.

Working capital increased from $4,174,000 at September 30, 1978 to $7,662,000 at September 29, 1979. This improvement is attributed, for the most part, to a partial waiver obtained from the Internal Revenue Service of the minimum funding requirements under the retirement and pension plans. Increased working capital, together with declining purchase prices for hogs, provided the funds needed to more fully utilize capacity.

Accordingly, processed meat operations at the Waterloo, Iowa, plant were increased early in the second half of the year and the level of slaughtering operations was substantially increased at this plant in September 1979. Also in September 1979, operations were resumed at the Columbus Junction, Iowa, plant which had been shut down since June 1978.

We are continuing to work with Locals of the United Food and Commercial Workers Union toward the adoption of a definitive agreement for a Stock Wage Payment Program. This Program, if implemented, would provide for covered employees to receive a portion of their weekly wages in common stock over a period of time until 1,800,000 shares of the company's authorized but unissued common stock have been distributed to the participants. Such stock will represent 60% of the company's total common stock expected to be outstanding upon completion of the distribution. This Program and operations of a related Employees' Trust to be established are subject to approval of the appropriate regulatory authorities and the stockholders, and ratification by the members of the bargaining units. Upon implementation of this Program, certain wages and benefits will be deferred for possible payment at later dates. The estimated amounts provided from the Stock Wage Payment Program and from the deferred wages and benefits would provide approximately $15,000,000 of additional working capital over the next three years.

If the Stock Wage Payment Program is approved by the stockholders and certain other conditions are met, the City of Waterloo, Iowa, will lend $4,510,000 to the company for improvements to the company's Waterloo plant from the proceeds of a tentatively approved grant received from the federal Department of Housing and Urban Development. The proposed loan would be for a ten-year term and would be secured by certain of the company's assets. Also, after meeting similar conditions, the maturity of the short-term loan of $2,980,000 obtained from the Black Hawk County Economic Development Committee, Inc., in October 1978 for working capital purposes would be extended to three years.

We are appreciative of the patience and cooperation shown by our customers, suppliers, and employees and by government officials who helped us reach a turnaround in the company's operations this year. Sales and operations are expected to continue at favorable levels for the year ahead, particularly during the first quarter.

Emmett A. McGuire

Emmet A. McGuire
President

December 21, 1979

The Rath Packing Company
Balance Sheet

ASSETS	September 29, 1979	September 30, 1978
CURRENT ASSETS:		
Cash	$ 1,083,000	$ 1,189,000
Restricted time deposits (Note 11)	1,932,000	685,000
Receivables (Note 6):		
Trade accounts	13,749,000	11,881,000
Other	2,037,000	1,723,000
	15,786,000	13,604,000
Less — Allowance for doubtful accounts	235,000	165,000
	15,551,000	13,439,000
Inventories (Notes 1 and 6):		
Meat and other products	15,816,000	14,982,000
Materials and supplies	4,141,000	2,980,000
	19,957,000	17,962,000
Prepaid expenses	714,000	679,000
Total current assets	39,237,000	33,954,000
PROPERTY, PLANT AND EQUIPMENT, at cost (Notes 1, 8 and 10):		
Buildings and leasehold improvements	16,810,000	17,259,000
Machinery and equipment	25,605,000	26,045,000
Leased property under capital leases	13,332,000	13,899,000
	55,747,000	57,203,000
Less — Accumulated depreciation and amortization	38,462,000	38,048,000
	17,285,000	19,155,000
Land	244,000	261,000
Improvements in process	352,000	72,000
	17,881,000	19,488,000
OTHER ASSETS:		
Intangible assets less accumulated amortization: 1979 — $450,000, 1978 — $359,000 (Note 1)	1,496,000	1,588,000
Noncurrent deposits and other assets (Note 11)	1,435,000	1,241,000
	2,931,000	2,829,000
	$60,049,000	$56,271,000

See Accompanying Notes to Financial Statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	September 28, 1979	September 30, 1978
CURRENT LIABILITIES:		
Borrowings under financing agreement (Note 6)	$ 4,680,000	$ 9,228,000
Note payable to Black Hawk County Economic Development Committee, Inc. (Note 7)	2,980,000	
Accounts payable	5,487,000	3,945,000
Accrued salaries, wages and vacations	6,583,000	4,835,000
Retirement and pension plan expense expected to be funded currently (Notes 1 and 4)	9,204,000	8,778,000
Other accrued liabilities	1,064,000	1,206,000
Current portion of mortgage note payable (Note 8)	857,000	643,000
Current portion of obligations under capital leases (Notes 1 and 10)	720,000	1,145,000
Total current liabilities	31,575,000	29,780,000
NONCURRENT LIABILITIES:		
Mortgage note payable (Note 8)	2,786,000	3,643,000
Retirement and pension plan expense not expected to be funded currently (Notes 1 and 4)	20,331,000	15,273,000
Obligations under capital leases (Notes 1 and 10)	6,423,000	7,156,000
	29,540,000	26,072,000
STOCKHOLDERS' EQUITY (DEFICIT):		
Common stock — par value $10 per share (Note 2): Authorized — 3,000,000 shares Outstanding — 1,192,750 shares	11,927,000	11,927,000
Capital in excess of par value	6,175,000	6,175,000
Accumulated deficit	(19,168,000)	(17,683,000)
	(1,066,000)	419,000
COMMITMENTS AND CONTINGENT LIABILITIES (Note 5)		
	$60,049,000	$56,271,000

See Accompanying Notes to Financial Statements.

Statement of Operations and Accumulated Deficit

	Fiscal year ended	
	September 29, 1979	September 30, 1978
Net sales	$316,895,000	$330,688,000
Costs and expenses:		
Cost of products sold	279,411,000	298,048,000
Delivery expense	12,555,000	12,836,000
Selling and administrative expenses	14,766,000	15,413,000
Depreciation and amortization (Notes 1 and 10)	1,842,000	2,051,000
Retirement and pension plan expense (Notes 1 and 4)	7,621,000	6,468,000
Interest expense (Notes 6, 7, 8 and 10)	2,185,000	2,313,000
	318,380,000	337,129,000
Net loss	(1,485,000)	(6,441,000)
Accumulated deficit:		
Beginning of year	(17,683,000)	(11,242,000)
End of year	($19,168,000)	($17,683,000)
Net loss per share	($1.25)	($5.40)

See Accompanying Notes to Financial Statements.

Statement of Changes in Financial Position

	Fiscal year ended	
	September 29, 1979	September 30, 1978
Cash was provided by (used for):		
Operations:		
Net loss	($1,485,000)	($6,441,000)
Charges (credits) not requiring or providing cash:		
Portion of provision for retirement and pension plan expense	5,484,000	6,130,000
Depreciation and amortization	1,842,000	2,051,000
Provision for doubtful accounts	70,000	98,000
Gain on sale of property, plant and equipment	(209,000)	(82,000)
(Increase) decrease in working capital employed in operations	(1,074,000)	657,000
Cash provided from operations	4,628,000	2,413,000
Proceeds of loan from Black Hawk County Economic Development Committee, Inc.	2,990,000	
Proceeds from sales of property, plant and equipment	598,000	230,000
Other	82,000	69,000
Total cash provided	8,298,000	2,712,000
Cash was used for:		
Net repayment of borrowings under financing agreement	4,538,000	672,000
Additions to property, plant and equipment	624,000	662,000
Packer bonding deposits, insurance deposits and deferred wages and benefits escrow	1,247,000	350,000
Repayment of mortgage note	643,000	428,000
Repayment of capital lease obligations	1,158,000	1,030,000
Other	194,000	
Total uses of cash	8,404,000	3,142,000
Decrease in cash	($ 106,000)	($ 430,000)
Components of change in working capital employed in operations:		
Current assets — (increase) decrease:		
Receivables	($2,182,000)	$ 831,000
Inventories	(1,995,000)	1,401,000
Prepaid expenses	(35,000)	54,000
Current liabilities — increase (decrease):		
Accounts payable	1,522,000	(919,000)
Accrued liabilities	1,616,000	(710,000)
(Increase) decrease in working capital employed in operations	($1,074,000)	$ 657,000

See Accompanying Notes to Financial Statements.

Notes to Financial Statements

NOTE 1—Accounting Policies:
A summary of major accounting policies follows:

Inventories:
Meat and other products are priced at approximate current market, less allowance for selling and distribution expenses. Materials and supplies are priced at the lower of first-in, first-out cost or market.

Property, plant and equipment:
Depreciation and amortization of property, plant and equipment, including leased property under capital leases, are computed using the straight-line method. Expenditures for repairs and maintenance are charged to operations; additions and betterments are capitalized. Gains or losses on sales or other disposition of property, plant and equipment are credited or charged to operations.

Leased property:
Leased facilities and equipment are accounted for as capital or operating leases in accordance with the criteria set forth in Financial Accounting Standards Board Statement No. 13.

Intangible assets:
Certain intangible assets arising from a business acquisition are being amortized on a straight-line basis over 25 years, which is the term (including optional renewal periods) of the major lease assumed in the purchase.

Retirement and pension plans:
The company has a contributory retirement plan for eligible salaried employees and two noncontributory pension plans for eligible hourly paid employees. In addition, a number of employees not eligible under the pension plans are covered by industry-wide pension plans. Retirement and pension plan expense includes normal costs plus interest on and amortization of unfunded prior service costs over a forty-year period, and amortization of actuarial gains and losses over periods not exceeding twenty years. Unfunded vested pension liabilities of a pension plan assumed and recorded in connection with an acquisition are being amortized over a forty-year period through a reduction of pension expense.

Federal income taxes:
Statements of operations of future profitable periods will include, until the net operating loss carry-over is utilized or expires (approximately $30,000,000 at September 29, 1979—Note 9), a provision in lieu of federal income taxes equivalent to taxes otherwise payable, with a corresponding credit classified as an extraordinary credit arising from utilization of the loss carry-over.

NOTE 2—Financing Arrangements and Employee Stock Wage Payment Program:
The company has reached an agreement in principle with three of the locals of the United Food and Commercial Workers Union representing approximately 1,800 of the company's employees at its Waterloo and Columbus Junction, Iowa, plants concerning a Stock Wage Payment Program. The agreement, which is subject to the execution of definitive documents, is also subject to approval of the stockholders and ratification by the members of the bargaining units, and will provide for covered employees to receive a portion of their weekly wages in common stock over a period of time, currently estimated at two and one half years, until 1,800,000 shares of the company's authorized but unissued common stock have been distributed to the participants. Implementation of the Stock Wage Payment Program, including the operation of a Rath Employees Trust to be established, is also subject to receipt of all necessary approvals from appropriate state and federal regulatory authorities.

Upon implementation of the Stock Wage Payment Program described above, certain wages and benefits will be deferred for possible payment at later dates pursuant to agreements with three union locals. The estimated amounts provided from the Stock Wage Payment Program and from the deferred wages and benefits would provide approximately $15,000,000 additional working capital over the next three years.

The City of Waterloo, Iowa, has received tentative approval from the federal Department of Housing and Urban Development (HUD) of its application for a grant of $4,630,000, of which $4,510,000 would be loaned to the company for improvements to be made to the company's Waterloo plant. The proposed loan would be for a term of ten years with an interest rate of three percent per annum and would be secured by real estate, inventory, and machinery and equipment. This grant will become effective when several conditions, including stockholder approval of the Stock Wage Payment Program described in the preceding paragraphs, are met.

The maturity of the short-term loan of $2,980,000 obtained from the Black Hawk County Economic Development Committee, Inc. in October 1978 for working capital purposes (Note 7) will be extended to three years under certain conditions, including stockholder approval of the aforementioned Stock Wage Payment Program.

NOTE 3—Resumption and Modifications of Certain Operations:
In September 1979, the company resumed operations at its Columbus Junction, Iowa, plant as the result of increased hog supplies, improved slaughtering margins, and availability of working capital. Severance pay charged to operations for the employees who elected not to return to work aggregated $252,000 and is payable in full by December 15, 1979.

In addition, in September 1979 the company substantially increased the level of slaughtering operations at its Waterloo, Iowa, plant for the same reasons as stated in the preceding paragraph. The higher slaughtering levels follow an earlier management decision to increase processed meat operations.

In August 1979 the company sold its Dallas, Texas, plant. The proceeds of the sale were principally in cash and a gain of $183,000 was realized. The company will continue to operate its distribution center from this building on a lease basis.

NOTE 4—Retirement and Pension Plans:
The total amounts expected to be paid in the 1980 and 1979 fiscal years were included as a current liability at September 29, 1979 and September 30, 1978 as summarized below:

	September 29, 1979	September 30, 1978
Rath pension plan:		
Annual instalments (including accrued interest) of deferred 1975 plan year contributions	$ 796,000	$1,163,000
Minimum contributions under ERISA for the 1979 and 1978 plan year, respectively	5,528,000	5,620,000
Annual instalment of ERISA minimum funding which was waived by the IRS:		
1977 plan year ...	520,000	484,000
1978 plan year ...	617,000	
	7,461,000	7,267,000
Rath retirement plan:		
Minimum contributions under ERISA for the 1979 and 1978 plan year, respectively	1,180,000	1,030,000
Annual instalment of ERISA minimum funding which was waived by the IRS:		
1977 plan year ...	83,000	83,000
1978 plan year ...	106,000	
	1,369,000	1,113,000
Indianapolis branch pension plan:		
Minimum contributions under ERISA for the 1979 and 1978 plan year, respectively	297,000	362,000
Annual instalment of ERISA minimum funding which was waived by the IRS:		
1977 plan year ...	36,000	36,000
1978 plan year ...	41,000	
	374,000	398,000
	$9,204,000	$8,778,000

No contribution was made to the Rath pension plan trust during the 1978 fiscal year. Payment of the $2,706,000 contribution to the Rath pension plan trust for the 1975 plan year has been deferred by agreement with the United Food and Commercial Workers Union. In September 1979 (date extended from previously agreed September 1978 date), the first of four equal annual payments plus accrued interest was made in the amount of $1,163,000. The second instalment of $798,000 is scheduled to be paid in September 1980, and therefore is included as a current liability. The balance of the contributions due for the 1975 plan year are scheduled to be paid in the 1981 and 1982 fiscal years.

ERISA requires minimum funding commencing with the 1976 plan year for the retirement plan and commencing with the 1977 plan year for the Rath pension plan and Indianapolis branch pension plan; however, a full waiver of the 1977 plan year and a partial waiver of the 1978 plan year ERISA minimum funding requirements have been received from the Internal Revenue Service. The partial waiver for the 1978 plan year was approved by the Internal Revenue Service, subject to a favorable vote of the stockholders for the Stock Wage Payment Program (Note 2). Pursuant to the waivers, the 1977 contribution and the balance of the 1978 plan year contribution plus interest are required to be funded over the fifteen-year period beginning the succeeding plan year (1978 and 1979, respectively). Accordingly, $603,000 was paid into the pension and retirement trusts in September 1979 for the 1977 waived amounts, and $1,403,000 has been included in the current portion of the accrued retirement and pension plan liability at September 29, 1979 for the 1978 amounts.

Because the 1976 and 1975 plan year contributions were not made to the Rath and Indianapolis branch pension trusts during the 1977 and 1976 fiscal years, unfunded liabilities under those plans are in excess of initial unfunded liabilities, as amended, a circumstance which permits the Internal Revenue Service to assert that there has been a discontinuance of contributions and that the plans are thereby terminated. Subsequent termination proceedings under ERISA, if instituted, could require payment (beyond amounts stated in the preceding paragraphs) by the company of certain unfunded vested liabilities of the plans up to thirty percent of employer net worth, as defined under such legislation. The company believes that the facts and circumstances surrounding the operation of the plans, which must be considered under Internal Revenue Service regulations, indicate that termination of the plans was not intended by the absence of contributions in 1975 and 1976.

Changes in benefits and actuarial assumptions increased fiscal 1979 pension expense by approximately $761,000. Pursuant to terms of the IRS waivers, increases in benefits or changes in accrual of benefits or vesting, subsequent to the 1979 plan year, cannot be effected until all ERISA required minimum funding waivers are paid.

Unfunded prior service costs of all plans aggregated approximately $76,000,000 at December 31, 1978 and $63,000,000 at December 31, 1977. At December 31, 1978, the actuarially computed value of vested benefits of the plans exceeded the total assets of the trusts (at cost) and balance sheet accruals by approximately $48,000,000.

NOTE 5—Commitments and Contingent Liabilities:

In August 1979, the plaintiff dismissed its case in a previously reported civil action brought against the company in 1976 in connection with an alleged breach of a brokerage contract for the sale of certain products. The plaintiff had been seeking compensatory damages of $1,075,000 and punitive damages in a like amount. The company has dismissed its counterclaim in this case and has settled a related cross-claim.

The company is a defendant in a civil action pending in the United States District Court for the Eastern District of New York by a terminated exclusive distributor of the company for an injunction, a declaratory judgment that the distribution agreement is still valid, for an accounting and for breach of contract, alleging damages of $1,050,000. The plaintiff's motion for a preliminary injunction filed in January 1978 was denied by the court in July 1979.

Labor agreements covering production employees provide for separation benefits for individuals who are placed in a layoff status exceeding two years, or who are terminated as the result of the closing of a part of the business or technological changes. Assuming discontinuance of all operations, estimated contingent severance pay at September 29, 1979 aggregated approximately $25,000,000.

best copy available

Substantially all retired employees of the company are covered at specified levels under life insurance policies and health insurance plans. The cost of such insurance coverage is borne by the company and is expensed when paid; amounts charged to operations during fiscal years 1979 and 1978 amounted to $1,443,000 and $1,075,000, respectively. At September 29, 1979, the actuarially computed present value of benefits earned by active and retired employees totaled $16,900,000.

NOTE 6—Financing Agreement:
All receivables and inventories have been pledged as collateral for borrowings under a financing agreement. The lender is a commercial finance company; however, two banks participate in the borrowings up to a maximum amount of $4,000,000. The total amount available for borrowing under the agreement varies as determined by the commercial finance company and amounted to $9,230,000 at September 29, 1979.

Interest rates are at five percent over the prime bank rate on the borrowings from the commercial finance company and at two percent over the prime bank rate on the borrowings from banks.

The maximum borrowings outstanding at the end of any accounting period during the years ended September 29, 1979 and September 30, 1978 were $7,980,000 and $9,974,000, respectively. The average outstanding borrowings for the 1979 fiscal year were $5,224,000, with a weighted average interest rate of 15.2%, and for the 1978 fiscal year were $8,106,000, with a weighted average interest rate of 12.2% (computed by dividing the annual interest expense on such borrowings by the average daily outstanding borrowings). The weighted average interest rates on borrowings outstanding at September 29, 1979 and September 30, 1978 were 16.6% and 12.8%, respectively.

The financing agreement, which became effective January 4, 1968, had an original term of five years and is renewable under its terms for one-year periods until terminated. The company, upon thirty days' notice, may prepay without penalty all borrowings thereunder provided funds used for prepayment are derived from unsecured bank borrowings, loans from institutional investors, equity financing or profitable operations. The lenders, upon sixty days' notice, may terminate the agreement at any time or may terminate without notice if the company becomes insolvent, takes action to go out of business, or the like.

NOTE 7—Note Payable to Black Hawk County Economic Development Committee, Inc.:
On October 19, 1978, the company obtained a loan of $2,980,000 from the Black Hawk County Economic Development Committee, Inc. for working capital purposes. The amounts were provided to the lender by a grant from the Economic Development Administration of the United States Department of Commerce. The loan had an original term of ninety days, which has been extended for several periods since the original due date and has a due date of December 17, 1979 as of November 13, 1979. Interest on the loan accrues at six percent per annum. Security for the loan consists of a lien on accounts receivable and inventories, subordinate to the lien established under the financing agreement discussed in Note 6. Long-term extension of the loan by the Committee is dependent, among other things, on a favorable vote of the company's stockholders for the Stock Wage Payment Program (Note 2).

NOTE 8—Mortgage Note Payable:
In March 1976, the company obtained a loan of $6,000,000 from a group of banks and savings and loan associations which has been used for working capital purposes. Loan principal and interest are 90% guaranteed by the Economic Development Administration of the U.S. Department of Commerce (EDA) and are secured by mortgages on property, plant and equipment located at Waterloo and Columbus Junction, Iowa. The loan is repayable in equal quarterly instalments through March 1, 1983 (approximately $857,000 annually). Interest is payable at 2½% above the prime bank rate in effect at the beginning of each quarter.

In 1978 the company obtained approval from the lenders and EDA to postpone until March 1, 1983 each of the principal payments of approximately $214,000, which were due on June 1, September 1 and December 1 of that year.

The mortgage loan agreement restricts acquisitions and redemption of the company's common stock and payment of dividends (other than stock dividends) to an aggregate amount of twenty percent of net earnings after January 24, 1976.

NOTE 9 –Federal Income Taxes:
Federal income tax returns are filed on a calendar-year basis. The approximate net operating loss carry-over available for federal income tax purposes at September 29, 1979 aggregated $10,100,000, comprising a carry-over of $8,700,000 as of December 31, 1978 ($1,600,000 expiring December 31, 1980, $3,000,000 expiring December 31, 1983 and $4,100,000 expiring December 31, 1985) plus a loss for federal income tax purposes of approximately $1,400,000 for the nine months ended September 29, 1979. In addition, there were loss carry-overs of approximately $19,900,000 at September 29, 1979 not recognized for tax purposes, which represent timing differences related to expenses recorded for financial statement purposes but not yet deducted for tax purposes.

Investment credit carry-overs aggregate approximately $483,000 and expire through 1986.

Federal income tax returns for years through December 31, 1975 (except for the year ended December 31, 1972) have been cleared through operation of the Statute of Limitations.

NOTE 10—Leasing Arrangements:
The company utilizes leased facilities in its operations which include four processing plants, three distribution centers and nine sales offices. The major processing plant lease, which has an original term of ten years expiring in 1984, with renewal options for three five-year periods, is a capital lease. The original terms for two of the processing plant capital leases are for 25 years, expiring in 1981 (renewal options extend through 2054) and 1983 (renewal options extend through 2033). The fourth processing plant lease, which is for ten years, expiring in 1980, is an operating lease. Most of the distribution center and sales office leases are operating leases, with lease expiration dates through 1991.

Operating leases for the distribution centers and sales offices generally permit the company to either purchase the property at the fair market value at the end of the initial lease term or renew the lease for five-year periods at the then fair rental value.

Certain of the company's meat processing and packaging equipment, data processing equipment and automobiles are leased under capital leases expiring on various dates through 1996. In addition, the company leases trucks and miscellaneous machinery and equipment under operating leases, expiring principally during the next four years.

Substantially all leases require the company to pay the cost of property taxes, insurance and repairs. In most cases, management expects that in the normal course of business leases will be renewed or replaced by comparable leases.

A summary of leased property under capital leases by major classification follows:

	September 29, 1979	September 30, 1978
Buildings	$ 8,338,000	$ 8,338,000
Machinery and equipment	4,994,000	5,561,000
	13,332,000	13,899,000
Less— Accumulated amortization	4,396,000	4,085,000
	$ 8,936,000	$ 9,814,000

At September 29, 1979, the future minimum lease payments under capital leases and the present value of the minimum lease payments are as follows:

Fiscal year	Amount
1980	$ 1,338,000
1981	1,102,000
1982	1,077,000
1983	917,000
1984	878,000
Thereafter	6,941,000
Minimum lease payments	12,253,000
Less— Amount representing interest	5,110,000
Present value of minimum payments	$ 7,143,000

The future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year at September 29, 1979 are as follows:

Fiscal year	Amount
1980	$ 1,178,000
1981	866,000
1982	611,000
1983	493,000
1984	377,000
Thereafter	1,027,000
	$4,552,000

Rentals charged to operations in the 1979 and 1978 fiscal years were $1,504,000 and $1,555,000, respectively.

NOTE 11—Restricted Time Deposits and U.S. Treasury Note:
Certificates of deposit for $1,185,000 at September 29, 1979 and September 30, 1978, respectively, have been pledged as collateral to an insurance company, and a bank trustee held $30,000 in a certificate of deposit at September 29, 1979 and $215,000 in certificates of deposit and a treasury note at September 30, 1978 in connection with the federal and state bonding requirements for purchasers of livestock. At each of the foregoing dates, $1,000,000 of the certificates of deposit has also been pledged, subordinate to the pledge to the insurance company, as collateral for borrowings under the financing agreement (Note 6). Of these amounts, $1,215,000 at September 29, 1979 and September 30, 1978, respectively, have been classified as noncurrent, as they cannot be used in the normal course of business.

To permit continued self-insurance for workmen's compensation, $500,000 has been deposited into a trust fund to be held to assure the payment of claims and is classified as a current asset. The insurance commission of the State of Iowa will review the necessity for and amount of this deposit by January 1980, the date to which the certificate for the company to self-insure has been issued.

In connection with agreements with three of the locals of the United Food and Commercial Workers Union, the company has deposited for Waterloo and Columbus Junction, Iowa, hourly and salaried employees $1,432,000 into escrow accounts at a bank, with the bank acting as trustee for these wages and benefits deferred since April 15, 1979. The trustee has invested these funds principally in certificates of deposit. These escrowed amounts will be returned to the company upon implementation of the Stock Wage Payment Program (Note 2) or to the respective employees to whom the amounts relate if the Stock Wage Payment Program does not become effective.

NOTE 12—Indemnification Trust:
On February 22, 1978, the stockholders ratified the action of the Board of Directors in adopting the terms of The Rath Packing Company Indemnification Trust, which provides for the deposit in trust of amounts approximating the premium costs of directors', officers' and fiduciaries' liability insurance for the purpose of fulfilling the company's indemnification obligations and providing a substitute for such insurance, which is currently unavailable to the company. The trust estate so created is held by the trustee for the benefit of corporate officers and directors for amounts they are legally liable to pay for wrongful acts and for defense costs connected therewith or with the successful defense of a claim of a wrongful act, as defined in the trust agreement and according to the terms and conditions therein. Upon termination of the trust agreement, the trustee shall convey the then remaining trust estate to the company. Deposits held by the trustee of $192,000 at September 29, 1979 and $128,000 at September 30, 1978 have been charged to operations.

Report of Independent Accountants

Price Waterhouse & Co.
200 EAST RANDOLPH DRIVE
CHICAGO, ILLINOIS 60601
312-565-1500

November 13, 1979

**To the Stockholders and
Board of Directors of
The Rath Packing Company**

We have examined the balance sheet of The Rath Packing Company as of September 29, 1979 and September 30, 1978 and the related statements of operations and accumulated deficit and of changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

During the fiscal years ended September 29, 1979 and September 30, 1978, the company incurred net losses of $1,485,000 and $6,441,000, respectively. Future working capital requirements are dependent on the company's ability to restore and maintain profitable operations, to restructure its financing arrangements and to continue the present short-term financing or obtain alternative financing as required. It is not possible to predict the outcome of future operations or whether the necessary alternative financing can be arranged, if needed. The accompanying fiscal year 1979 and 1978 financial statements have been prepared on the basis of accounting principles applicable to a going concern. Accordingly, they do not purport to give effect to adjustments, if any, that may be necessary should the company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities, contingent obligations and commitments in other than the normal course of business and at amounts different from those in the accompanying fiscal year 1979 and 1978 financial statements.

As described in Note 5, the company was a defendant in two lawsuits alleging breach of brokerage contracts and claiming compensatory and punitive damages; however, one of the lawsuits was dismissed in August 1979. The ultimate outcome of the other lawsuit is not presently determinable. Accordingly, no provision for liability, if any, has been made in the fiscal year 1979 or 1978 financial statements.

In our opinion, subject to the effects on the fiscal year 1979 and 1978 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the two preceding paragraphs been known, the financial statements examined by us present fairly the financial position of The Rath Packing Company at September 29, 1979 and September 30, 1978 and the results of its operations and the changes in its financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Price Waterhouse & Co.

Quarterly Operating Results and Stock Price Data

Unaudited quarterly results of operations for the years ended September 29, 1979 and September 30, 1978 are shown in the following table:

1979	Net sales	Net earnings (loss)	Earnings (loss) per share
First quarter	$ 72,653,000	$(1,094,000)	$ (.92)
Second quarter	77,012,000	(1,453,000)	(1.22)
Third quarter	85,394,000	56,000	.05
Fourth quarter	81,836,000	1,006,000	.84
	$316,895,000	$(1,485,000)	$(1.25)
1978			
First quarter	$ 93,622,000	$ 514,000	$ .43
Second quarter	80,194,000	(2,133,000)	(1.79)
Third quarter	84,937,000	(2,326,000)	(1.95)
Fourth quarter	71,935,000	(2,496,000)	(2.09)
	$330,688,000	$(6,441,000)	$(5.40)

Net earnings for the fourth quarter of 1979 include a credit of $308,000 for an estimated refund in connection with the settlement of a class action litigation against certain manufacturers of folding cartons.

The company's common stock is listed on the Midwest Stock Exchange and is traded on the American Stock Exchange. The high and low sales prices on the American Stock Exchange during each quarter of the 1979 and 1978 fiscal years follow:

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	High	Low	High	Low	High	Low	High	Low
1979	**3⅝**	**2**	**3⅛**	**2**	**2½**	**2**	**4⅞**	**2**
1978	**4½**	**3**	**3¾**	**2⅞**	**3½**	**2⅞**	**3⅝**	**2¾**

No dividends were declared or paid on the company's common stock during the 1979 and 1978 fiscal years.

Summary of Operations

	Fiscal year ended					
	September 29, 1979	September 30, 1978	October 1, 1977	October 2, 1976 (53 weeks)	September 27, 1975	September 28, 1974
	(Dollars stated in thousands, except per share figures)					
Net sales of continuing operations	$310,895	$330,688	$365,197	$388,887	$399,365	$372,314
Cost of products sold	$279,411	$298,048	$325,760	$357,990	$365,728	$336,613
Interest expense	$ 2,185	$ 2,313	$ 2,320	$ 2,764	$ 2,879	$ 1,574
Earnings (loss) from continuing operations before provision in lieu of federal income taxes	$ (1,485)	$ (6,441)	$ (999)	$ (6,811)	$ (5,862)	$ 600
Provision in lieu of federal income taxes						285
Earnings (loss) from continuing operations before extraordinary credit	(1,485)	(6,441)	(999)	(6,811)	(5,862)	315
Discontinued Feed Division operations:						
Earnings (loss) from operations					(163)	8
Loss on disposal			(19)	(107)	(325)	
			(19)	(107)	(488)	8
Earnings (loss) before extraordinary credit	(1,485)	(6,441)	(1,018)	(6,918)	(6,350)	323
Credit arising from utilization of net operating loss carry-over						285
Net earnings (loss)	$ (1,485)	$ (6,441)	$ (1,018)	$ (6,918)	$ (6,350)	$ 608
Earnings (loss) per share:						
Earnings (loss) from continuing operations before extraordinary credit	$ (1.25)	$ (5.40)	$ (.84)	$ (5.71)	$ (4.91)	$ .26
Earnings (loss) related to discontinued operations			(.01)	(.09)	(.41)	.01
Earnings (loss) before extraordinary credit	(1.25)	(5.40)	(.85)	(5.80)	(5.32)	.27
Extraordinary credit						.24
Net earnings (loss)	$ (1.25)	$ (5.40)	$ (.85)	$ (5.80)	$ (5.32)	$ .51

Average number of shares outstanding used in computing earnings (loss) per share each year — 1,192,750

Management's Comments on Summary of Operations

1979 compared with 1978:
The decreases in net sales and cost of products sold in 1979 are accounted for principally by an 11% decrease in pounds of products sold because of lower volumes in the first half of the year. The gross margin on sales in 1979 improved from 9.9% to 11.9% as a result of hog purchase prices declining at a greater rate than pork product selling prices.

1978 compared with 1977:
Net sales and cost of products sold were both substantially lower in 1978 because of a 23% reduction in the number of pounds of products sold. The major reason for this decline in sales volume is the reduction in hog slaughter operations particularly at the Columbus Junction, Iowa, plant which was shut down during part of the year. Selling prices were higher in 1978 to cover higher hog purchase prices and production costs but the resulting margins on slaughter and sales were lower.

1977 compared with 1976:
Although sales volume, in pounds, increased by 10% in 1977, sales, in dollars, decreased because of lower selling prices related to lower purchase costs for hogs included in cost of products sold. Cost of products sold also decreased in 1977 because of the inclusion in 1976 of significant unfavorable adjustments of inventories to reflect substantial declines in market prices of meat products during the year compared with favorable inventory adjustments in 1977.

Lower average borrowings and a lower average interest rate account for the decrease in interest expense in 1977.

1976 compared with 1975:
The reduction in net sales and cost of products sold in 1976 from the amounts in 1975 were largely caused by a 9% decline in pounds of products sold which were offset, only in part, by higher average selling prices realized and higher average costs incurred. Cost of products sold for 1976 includes significant unfavorable adjustments of inventories to reflect a substantial decline in market prices of meat products during the year compared with favorable inventory market adjustments in 1975.

Interest expense was lower in 1976 than 1975 because of a lower average borrowing level and lower average interest rate.

1975 compared with 1974:
Net sales and cost of products sold were higher in 1975 because of the inclusion of the operations of the Stark, Wetzel Foods Division after the November 4, 1974 acquisition date and because of higher average prices realized on 1975 sales related to higher average costs. These increases were offset, in large part, by the effect of a significant reduction in the number of pounds of product produced and sold. The substantially reduced supply of hogs available for slaughter in 1975 was the major reason for the lower plant operating and sales volume.

The increase in interest expense in 1975 is attributable to a higher average borrowing level which was offset, in part, by the lower average rate of interest on such borrowings.

Form 10-K
A copy of the company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the 1979 fiscal year will be mailed to stockholders, without charge, upon written request to John H. Stevens, Secretary, The Rath Packing Company, P.O. Box 330, Waterloo, Iowa 50704.

The Rath Packing Company
Sycamore at Elm
Waterloo, Iowa 50703

ATTACHMENT F

The Rath Packing Company First Quarter Report 1980

TO OUR STOCKHOLDERS

The Rath Packing Company
Sycamore at Elm
Waterloo, Iowa 50703

Although operating results for the first quarter of 1980 were adversely affected by a strike by employees of the company's Indianapolis plant during the last five weeks of the period, net sales and net earnings were substantially higher than in the first quarter of 1979. For the thirteen weeks ended December 29, 1979, the company had net earnings of $1,701,000, or $1.43 per share, including a credit of $763,000, or $ .64 per share, arising from utilization of a net operating loss carry-over. On a comparable basis for the same quarter last year, there was a net loss of $1,094,000, or $ .92 per share. Net sales were $107,181,000 for the current quarter and $72,653,000 for the same quarter of the preceding year.

Sales, in total pounds, were 101% higher in this quarter than a year ago when operations were restricted by working capital limitations. Working capital improvement since last year provided the funds for increased purchases from a larger supply of hogs and for greater utilization of our plant capacities. This higher level of operations accounts for the large increase in fresh meat sales. Processed meat sales volume was ahead principally because of aggressive marketing and sales strategies. A significant improvement in profit margins was also realized on sales of both fresh and processed meat products.

The preparation of documents concerning the proposed Stock Wage Payment Plan described in the company's 1979 annual report which are needed for filing with regulatory authorities is progressing. Completion and filing of the documents are dependent, among other things, on the completion of negotiations of definitive agreements with the principal union local representing employees of the company's Waterloo, Iowa, plant and favorable disposition of a lawsuit brought by eight employees concerning the proposed deferment of certain wages and benefits.

It appears that there will be an adequate supply of hogs during the remainder of this year. The profitable operating results of this first quarter have provided funds which will be applied to the purchase of hogs and to the continuation of production and sales volumes at satisfactory levels; however, profit margins from slaughter operations and from sales are expected to be less favorable than those realized in the first quarter. Typically, the first quarter is the best quarter of the year for Rath, although in 1978 it was not. Because of wide fluctuations that often occur in operating results in this unusually volatile industry, it should not be assumed that the substantially improved results of the first quarter of this year are indicative of what the results for the remaining quarters will be.

Emmet A McGuire

January 24, 1980 Emmet A. McGuire, President

SUMMARY OF OPERATIONS
(Unaudited)

	Thirteen weeks ended December 29, 1979	Thirteen weeks ended December 30, 1978
Net sales	$107,181,000	$ 72,653,000
Earnings (loss) before provision in lieu of federal income taxes	$ 1,701,000	$ (1,094,000)
Provision in lieu of federal income taxes	763,000	
Earnings (loss) before extraordinary credit	938,000	(1,094,000)
Credit arising from utilization of net operating loss carry-over	763,000	
Net earnings (loss)	$ 1,701,000	$ (1,094,000)
Earnings (loss) per share:		
Earnings (loss) before extraordinary credit	$ .79	$ (.92)
Extraordinary credit	.64	
Net earnings (loss)	$ 1.43	$ (.92)
Average number of shares outstanding during both periods—1,192,750		

APPENDIX P.—MATERIAL SUPPLIED BY HON. TOM TAUKE: DAVID BARKLEY ON PLANT OWNERSHIP CHARACTERISTICS IN IOWA

TOM TAUKE
[illegible]

[illegible]
EDUCATION AND LABOR
SMALL BUSINESS

CONGRESS OF THE UNITED STATES

February 11, 1980

The Honorable Berkley Bedell
Chairman
Subcommittee on Antitrust
Committee on Small Business
U. S. House of Representatives
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

It has been with great interest that I have participated in our Subcommittee's hearings on conglomerate mergers and their effects on small business and local communities. I believe that it is of particular significance that the Subcommittee has chosen to focus its attention on the study of communities that have been affected by conglomerate acquisitions.

In 1978, David Barkley published an extensive study of plant ownership characteristics of manufacturers in our home state of Iowa. I would like to make available to the entire Subcommittee Professor Barkley's article "Plant Ownership Characteristics and the Locational Stability of Rural Iowa Manufacturers," published in the February 1978 issue of Land Economics.

Enclosed please find a copy of the article. I also recommend that you consider including the study in the Subcommittee's hearing record.

Sincerely,

Tom Tauke

Tom Tauke
Member of Congress

TT/gh

Enclosure

COMMUNICATIONS SHOULD BE DIRECTED TO THE OFFICE INDICATED

☐ [illegible]
Washington, D.C. [illegible]
[illegible]

☐ [illegible]
[illegible]
[illegible]

☐ [illegible]
[illegible]
[illegible]

☐ [illegible]
[illegible]
[illegible]

Plant Ownership Characteristics and the Locational Stability of Rural Iowa Manufacturers

David L. Barkley

During each of the last eleven years, an average of over 4,000 jobs were eliminated in nonmetropolitan Iowa alone because of industrial outmigration or failures. Despite the magnitude and consequences of this phenomenon, industrial outmigration has been studied relatively little by rural development organizations or regional economists. Too frequently plant closings have been dismissed as simply a random occurrence over which the community has little control. However, these closings are not as random as casual observation would lead one to believe. Manufacturers are not homogeneous; they differ in the types of goods produced, plant size, resources required, proximity to inputs and markets, and ownership characteristics (branch plants versus independent concerns). These factors can affect the locational stability of firms—i.e., the probability of failure or migration—just as disparities in age, sex, race, and education affect the outmigration rates of workers.

The purpose of this paper is to determine if the locational stability of an area's manufacturers is dependent on the ownership characteristics of that area's industry. It shall be demonstrated that locally owned firms exhibited a higher propensity for failure than multiplant corporations. However, in spite of a superior survival rate, the locational instability of branch plants still exceeded that of independent concerns because of their relatively high outmigration rates. As a result of these inherent instabilities, communities with a relatively heavy concentration of branch plants can expect to experience greater difficulty in maintaining or increasing their industrial base.

THEORETICAL FOUNDATIONS

The loss of an existing industry to a community results either from failure and subsequent closings or from plant outmigration—i.e., the relocation of production in another community. Theoretically, branch plants and independent concerns are not equally susceptible to the above phenomena.

The author is Assistant Professor of Economics, University of Redlands. The research for this article was conducted while the author was a graduate student and research assistant at Iowa State University. He would like to thank Iowa State University for their funding of the project and Professors Arnold Paulsen and James Prescott, and the Iowa Development Commission for valuable assistance and encouragement. He also thanks Professor George Thomas of the University of Redlands and an anonymous reviewer for constructive criticisms.

Multiplant firms realize certain economies that only the larger independent manufacturers are capable of obtaining. The most frequently mentioned of these are: (1) savings on management services, (2) pecuniary economies, (3) centralized research and development, (4) massed reserves, (5) transportation costs, and (6) marketing, advertising, and image benefits. In Bain's study on the operations of multiplant firms, he discovered some industries in which these economies equaled two to five percent of total costs [1954, pp. 29-33]. Given these savings, and the oft noted ability of multiplant corporations to attract more capable managers and maintain easier access to financial markets, branch plants should more easily be able to survive a cyclical or secular downturn in sales. However, the locational stability of branch plants still may be inferior to that of local manufacturers if their propensity for outmigration greatly exceeds that of indigenous firms. This inclination for branch plant migration during periods of depressed demand results from:

(1) the ability of multiplant firms to increase production efficiency by consolidating production into fewer plants;

(2) the ability of multiplant concerns to reduce overhead costs by closing branches and transferring production elsewhere;

(3) the fact that indigenous firms are more likely to experience locational inertia than plants whose owners reside outside the community.

The primary impetus for multiplant firms to maintain production at all facilities would be to minimize transportation costs. Therefore, whether branches are in fact less locationally stable than independent firms will depend on the relative importance of efficiency, overhead, and transportation costs versus locational inertia and the differential survival rate.

SOURCES AND ANALYSIS OF DATA

To investigate the relationship between ownership characteristics and plant locational stability, a sample of Iowa plant closures in non-Standard Metropolitan Statistical Areas (SMSAs) and data concerning each had to be generated.[1] The following series of operations were required. First, those firms which failed or outmigrated were isolated from the survivors. This entailed comparing the listings in the 1965-66 through 1973-74 *Directory of Iowa Manufacturers* with the 1975-76 edition, and noting those companies whose names appeared in the earlier directories but not in the latest publication.[2] Next, these apparently "deceased" firms were classified according to communities and size.[3]

---

[1] The sample space was restricted to non-SMSA Iowa in order that those interviewed would better be able to recall the characteristics of those plants which closed in the not so recent past.

[2] Iowa Development Commission [1966, 1968, 1970, 1972, 1974, 1976].

[3] Since the procedures used to obtain data on closed plants relied heavily on the respondents' memories, only firms employing twenty or more workers during some stage of their existence were considered for the sample. It also should be noted at this time that rural Iowa milk processors were not included in the survey. They were excluded because (1) all creamery closings resulted from changes in milk-processing technology, and (2) it would have been extremely difficult to differentiate between plant closings and mergers and acquisitions.

Finally, knowledgeable individuals in each community and, whenever possible, executives associated with the "potentially outmigrating" firm were contacted by telephone.[4] These persons were requested to confirm or deny the closing or outmigration of particular plants in their community or with their company. In many cases, the plants provided by the "survival" method were too small to include, or they were still in operation but under a different name. If operation had in fact ceased, the following information was solicited:

(1) The year the company ceased production in the community.
(2) The estimated peak employment of the plant.
(3) The principal products produced by the company in the community.
(4) The ownership characteristics of the concern; i.e., was the facility locally owned, not locally owned but an independent operation, or a branch or subsidiary of another company.
(5) If the plant was a branch or subsidiary, who was the parent company and where were its headquarters?
(6) Had the plant, or parent company of the plant, been acquired by another individual or company during its life in the community? If so, when did this acquisition (merger) occur and who was the acquiring party?
(7) The reasons for halting production or moving out of the community.
(8) The names of any management personnel who had remained in the area after the local operation had ceased.

If other sources of information (such as corporate executives, previous employees, or the original owners) were available, they were also contacted and requested to answer the above questions.

In total, 197 communities plus numerous companies and employees were contacted. During the period covered by this study (1965-75), 128 plants employing over 20 workers failed or outmigrated from rural Iowa. Of these 128 firms, 75 were branch plants and the remaining 53 were locally owned concerns.[5]

DERIVATION OF LOCATIONAL INSTABILITY RATES

It was previously hypothesized that the probability of failure of a unit firm exceeded that of a multiplant corporation, yet branch plants were still less locationally stable because of their greater propensity for migration. To test these hypotheses, locational instability rates were computed for the sample of closed Iowa manufacturers. These rates are simply the ratio of the number of outmigrating and failing firms in a select classification (SIC, employment size, branch plants, local plants, location, etc.) to the total number of rural Iowa manufacturers in such a category at a particular point in time (in this case 1973-74). Plant closings for the entire study period (1965-75) were included in the computation of these rates to minimize the importance of cyclical variation in migrations and failures. The denominators for the ratios were obtained from the 1973-74 *Directory of Iowa Manufacturers.*

---

[4] The most frequently contacted individuals in the communities were persons of leadership level in the local development commissions or chambers of commerce, Iowa State Extension personnel, or the mayors or bank presidents of the smaller municipalities.

[5] Because of the high degree of cooperation I received during these interviews, it is my judgment that the 128 firms represent almost all of the rural Iowa manufacturers which had employed over twenty workers and outmigrated or ceased production during the last ten years. It is also my opinion that the information concerning each is accurate, though this accuracy is possibly less for those closed several years ago.

If branch plants were in fact less locationally stable than unit concerns, their locational instability rates must be significantly greater than those of the indigenous firms. However, this rate differential does not conclusively prove that ownership characteristics were the source of the instability differences. Branch and local plants also differed significantly in the types of products produced ($\chi^2 = 3.02$) and in the distribution of their plant sizes ($\chi^2 = 85.45$) (refer to Tables 1 and 2). If a disproportionately large number of rural Iowa branches were producing in "declining" or "footloose" industries, or if large plants were more responsive to changes in locational advantage than smaller companies (possibly because of better access to the capital markets or superior management), the locational instability credited to ownership may have actually resulted from disparities in industrial composition and plant size. The influence of these variables was controlled for by computing locational instability rates within select industrial and employment classes. Had multiplant firms exhibited a greater propensity for plant closings due to the possibility of achieving scale economies and the relative absence of locational inertia, the locational instability rate of branches should exceed that of indigenous companies regardless of the product type or employment categories utilized. A higher rate of closings for branches could also result if branch plants were more heavily concentrated in the higher transit cost western region of the state than were unit concerns.[6] However, such a distribution did not occur (see Table 3). The proportion of the state's branch plants in each region (eastern and western Iowa) was almost identical to the proportion of the state's unit firms in those areas ($\chi^2 = 1.73$). Since no significant difference existed, controlling for the influence of location on instability rates was not necessary.

SUMMARY OF FINDINGS

The statistical findings of this study provide strong support for the previous hypotheses.[7] The probability of an independent company failing exceeded that of a multiplant firm. Plant closings resulting from branch and local company failures were 19 and 37, respectively. These represented 5.43 percent of the 1973-74 base for multiplant firms and 8.73 percent for local concerns. However, in spite of a lower bankruptcy rate, rural Iowa branch plants were still significantly less locationally stable than indigenous manufacturers (Table 4). The locational instability rate of branches was approximately 50 percent greater than that of local firms, and branch plant stability was not significantly influenced by the location of the multiplant corporations' headquarters (Iowa versus non-Iowa).

---

[6] The line of demarcation closely followed the route of Interstate Highway 35.

[7] The statistical tests of significance applied throughout this section are tests for differences between proportions.

TABLE 1
EMPLOYMENT CHARACTERISTICS OF RURAL IOWA MANUFACTURERS, BRANCH VERSUS LOCAL, 1973-74

Employment Classes	Local	Percent of Local	Branch	Percent of Branch	Total	Percent of Total
21-50	263	62%	112	32%	375	48%
51-100	87	21	84	24	171	22
101-250	50	12	93	27	143	18
251-500	16	4	37	11	53	7
501-1,000	6	1	13	4	18	2
1,000+	2	0.5	11	3	13	2
Total	424		350		774	

Source: Calculated from Iowa Development Commission [1974].

TABLE 2
INDUSTRIAL COMPOSITION OF RURAL IOWA MANUFACTURERS, BRANCH VERSUS LOCAL, 1973-74

Industrial Composition*	Local	Percent of Local	Branch	Percent of Branch	Total	Percent of Total
Durable	211	49.8%	153	43.7%	364	47.0%
Nondurable	213	50.2	197	56.3	410	53.0
Total	424		350		774	

Source: Calculated from Iowa Development Commission [1974].

*The following delineation was adopted for industrial composition: food and kindred products, tobacco, textiles, apparel, paper, printing, publishing, leather, rubber, petroleum, coal, and chemical products were classified as nondurable goods. Lumber, furniture, fixtures, stone, clay, glass, primary metals, fabricated metals, machinery, transportation equipment, and instruments were classified as durable goods.

TABLE 3
DISTRIBUTION OF RURAL MANUFACTURERS BETWEEN EASTERN AND WESTERN IOWA, BRANCH VERSUS LOCAL, 1973-74

Location	Local	Percent of Local	Branch	Percent of Branch	Total	Percent of Total
Eastern Iowa	261	61.6%	232	66.3%	493	66.7%
Western Iowa	163	38.4	118	33.7	281	36.3
Total	424		350		774	

Source: Calculated from Iowa Development Commission [1974].

The locational stability of rural Iowa manufacturers was significantly affected by plant size ($\chi^2 = 2.56$); however, no employment size-stability pattern was discernible (Table 5). Furthermore, the variation in stability rates by employment classes can be attributed almost entirely to differences in the lo-

TABLE 4
LOCATIONAL INSTABILITY RATES FOR BRANCH AND LOCAL PLANTS, NON-SMSA IOWA, 1965-75

Ownership Characteristics	Locational Instability Rates (expressed as a percent)
Local	12.50]*
Branch	21.43]
Branch(HQ in Iowa)	24.53
Branch (HQ not in Iowa)	21.21
All rural Iowa plants	16.54

*Significantly different at the .5 percent level.

cational stability of branch plants. The probability of local firm outmigration or failure was not significantly influenced by plant size ($\chi^2 = .55$). Within each employment category, the locational instability rates of branch plants consistently exceeded those of the indigenous concerns. These results indicate that the differences in branch and unit firm locational instability rates cannot be attributed to a skewed distribution of plant sizes.

The locational stability of Iowa manufacturers was also significantly influenced by the type of products they produced (Table 6). The manufacturers of durable goods exhibited rates significantly larger than those of the producers of nondurable goods, and the locational instability of firms in the electrical and lumber industries was significantly greater than that for all Iowa plants.[8] However, within product groups, branch plants were more locationally unstable than indigenous firms. The probability of branch plant failure or outmigration was significantly greater than that of unit firms for all product classifications except nondurable goods. Furthermore, the locational instability of indigenous firms varied little among product classes. With the exception of the wood products manufacturers, the instability rates of local firms within the selected product groups never deviated more than two and one-half percentage points from the Iowa average for unit concerns. Therefore, the observed differences between the aggregate rates of each group resulted primarily from changes in branch plant instability. To summarize, the locational stability of a region's industry will be altered by the size distribution of that region's plants and its industrial composition. However, that instability will be transmitted to the industrial base through the area's branch plants. The stability rates of a community's manufacturers will be only minimally affected by plant size and product mix if all of the community's industries are locally owned.

CONCLUSION

In recent years, renewed interest has been shown in rural development. Regional, state, and local organizations were formed to undertake the measures necessary to raise area incomes, reduce the rural-to-urban migration, and augment the amenities

---

[8] The relatively high instability rates for manufacturers in these industrial groups may have resulted from the following features: (1) The lumber and electrical industries are engaged in the production of durable goods, and are, therefore, more susceptible to fluctuations in aggregate demand. (2) The U.S. South and Japan had developed comparative advantages in the production of wood products and electrical equipment, respectively. Competition from these regions forced Iowa manufacturers to seek "lower cost" locations.

TABLE 5
LOCATIONAL INSTABILITY RATES FOR RURAL IOWA PLANTS ACCORDING TO SIZE OF EMPLOYMENT, BRANCH VERSUS LOCAL, 1965-75

Employment Classes	Locational Instability Rates (expressed as a percent)		
	Aggregate	Branch	Local
21-50	15.73	22.32	12.93
51-100	19.30	26.19	12.64
101-250	14.68	17.20	10.00
251-500	15.09	16.22	12.50
501+	21.87	25.00	12.50
All Iowa Plants	16.54	21.43	12.50

TABLE 6
LOCATIONAL INSTABILITY RATES OF RURAL IOWA MANUFACTURERS ACCORDING TO TYPES OF GOODS PRODUCED AND OWNERSHIP CHARACTERISTICS, 1965-75

Product Classification	Locational Instability Rates (expressed as a percent)			
	All Plants		Branch	Local
Durable goods	19.78	**	(28.10	13.74)***
Nondurable goods	13.55		16.24	11.27
Food and kindred products (SIC #20)	20.11		(24.42	14.77)*
Electrical equipment and supplies (SIC #36)	28.26		(41.67	13.65)**
Lumber, wood products, furniture, and fixtures (SIC # 24 and #25)	* 25.86	**	(43.75	19.04)**
All Iowa manufacturers	16.54		(21.43	12.50)***

*Significantly different at the 10 percent level.
**Significantly different at the 5 percent level.
***Significantly different at the .5 percent level.

offered by rural areas. The inducement of industry into nonmetropolitan communities has been viewed as one means of achieving the above goals. However, these attempts at industrial expansion are often frustrated by the loss of existing manufacturers due to outmigration or failure. The probability of such a loss is high (approximately 15 percent of rural Iowa manufacturers closed during the last ten years), and the impact on the local economy can be serious. To reduce the possibility of these closings and to provide a healthy industrial base, development organizations should be (whenever possible) somewhat selective about the type of manufacturers they solicit. According to Isard,

> The percent of a region's activities in durables, the presence of growth industries in its industrial mix, the diversity of its industrial structure, the sensitivity of each of its individual production lines, the direction and rate of change of its underlying secular position are all factors to be considered in the formulation of policy for the region and in the programming of its development [1960, p. 188].

The results of this study indicate that the ownership mix of a region's industry should also be included with the above factors. Strict adherence to the above policy guidelines may be unrealistic for those communities whose current level of industrialization is far below what they desire. However, if a municipality is confronted with the choice of using its developmental resources (such as industrial revenue bonds or a complementary site) to either aid in the expansion of an indigenous manufacturer or encourage the establishment of a multiplant firm's branch in their community, then, ceteris paribus, the greater long-run benefit to the area would probably be derived from the expansion of the home-grown industry. This benefit results from the tendency of independent concerns to be more locationally stable than branch plants.

References

Bain, Joe S. 1954. "Economies of Scale, Concentration, and the Condition of Entry in Twenty Manufacturing Industries." *American Economic Review* 44 (March): 15-39.

Barkley, David L. 1976. "The Factors Contributing to Industrial Outmigration from Rural Areas of Iowa." Ph.D. dissertation, Iowa State University.

Estall, R. C., and Buchanan, R. Ogilvie. 1973. *Industrial Activity and Economic Geography*. 3rd (revised) ed. London: Hutchinson and Co., Ltd.

Eversley, D. E. C. 1965. "Social and Psychological Factors in the Determination of Industrial Location." In *Papers on Regional Development*, ed. Thomas Wilson. Oxford: Basil Blackwell, Ltd.

Hamilton, F. E. Ian, ed. 1974. *Spatial Perspectives on Industrial Organization and Decision-making*. London: John Wiley and Sons, Ltd.

Haren, Claude C. 1970. "Rural Industrial Growth in the 1960's." *American Journal of Agricultural Economics* 51 (Aug.): 431-37.

Hoover, Edgar M. 1948. *The Location of Economic Activity*. New York: McGraw-Hill.

Iowa Development Commission. 1964, 1966, 1968, 1970, 1972, 1974 and 1976. *Directory of Iowa Manufacturers*. 5th through 11th editions. Des Moines: Iowa Development Commission.

Isard, Walter. 1960. *Methods of Regional Analysis: An Introduction to Regional Science*. Cambridge, Mass.: The MIT Press.

Kamerschen, David R. 1968. "The Influence of Ownership and Control on Profit Rates." *American Economic Review* 58 (June): 422-47.

Krumme, Gunter, and Hayter, Roger. 1975. "Implications of Corporate Strategies and Cycle Adjustments for Regional Employment Changes." In *Locational Dynamics of Manufacturing Activity*, eds. Lyndhurst Collins and David F. Walker. London: John Wiley and Sons, Ltd.

Lever, William F. 1973. "Cyclical Changes in Factors Affecting Industrial Location." *Land Economics* 49 (May): 218-21.

Mueller, Eva; Wilken, Arnold; and Wood, Margaret. 1961. *Location Decisions and Industrial Mobility in Michigan, 1961*. Ann Arbor: The University of Michigan Institute for Social Research.

Scherer, F. M. 1970. *Industrial Market Structure and Economic Performance*. Chicago: Rand McNally and Co.

Williams, Sheldon W.; Vose, David A.; French, Charles E.; Cook, Hugh L.; and Manchester, Alden C. 1970. *Organization and Competition in the Midwest Dairy Industries*. Ames: Iowa State University Press.

APPENDIX Q.—ROBERT STERN AND HOWARD ALDRICH—PRESENTATION TO THE FTC CONFERENCE ON FIRM SIZE, MARKET POWER AND SOCIAL PERFORMANCE

The Effect of Absentee Firm Control on Local Community Welfare: A Survey

by

Robert N. Stern and Howard Aldrich
New York State School of Industrial and Labor Relations
Cornell University

Presented at the FTC Bureau of Economics conference on "Firm Size, Market Power and Social Performance." in Washington, D.C., January 17-18, 1980.

"Economies" are defined territorially by exchange relations and the division of labor, whereas "polities" are defined by authoritative control within the boundaries of a politically-defined area. Economic actors, whether they are entrepreneurs or corporations, seek the free flow of capital and commodities without regard to arbitrary boundaries, whereas political actors intervene in such flows by virtue of their authoritative control over all actions within their boundaries. Most orthodox approaches appear to assume the congruence of political and economic systems at the nation-state level, with national governments playing important roles in creating the legal and political infrastructures supporting national economies. Regional and local political units, however, do not enjoy such an unchallenged status, and their proper economic role is rather undefined.

Our review of the literature on absentee owned firms has led us to posit a fundamental contradiction between actors desiring the free flow of economic capital and actors attempting to defend the integrity of local political boundaries.[1] Local communities establish public policies facilitating or constraining the movement of capital, but their limited size prevents them from exercising the coercive powers of the federal government. Large corporations accept the facilitating acts of local governments but view constraints as a nuisance, inhibiting the efficient allocation of resources.

Two accounting systems are implied by these contradictions: one system for evaluating costs and benefits of capital movements within the boundaries of the nation economy, and another for assessing the effect of corporate activity on members of specific communities. Differences in evaluation criteria produce complementary as well as conflicting assessments of corporate actions. Actions perceived as advantageous from a corporation's perspective may generate a rather different view from the viewpoint of community residents.

Dual systems of social accounting became the norm in America with the development of a nationally-integrated industrial economy between 1880 and 1930.[2] An intimate industry-community-government nexus was apparent in the earliest sociological studies of community life.[3] Local owners of productive enterprises provided community political leadership, were integrated into local stratification systems, and were committed to the community as a location for social and political life, as well as work.[4] As national markets developed, assets became concentrated, and firm sizes increased, many corporations owned and run by community residents were sold to growing corporations based in the largest urban centers.[5] The creation of absentee owned corporations created a calculus of corporate welfare separate from that of community welfare. Though the corporation still required the cooperation of local governments and labor forces, the community simply became a geographic location in which to operate as long as relative cost advantages were maintained. Commitment to the community itself and knowledge of the local social structure declined because professional managers sent to run these branch plants were more concerned with their careers in the larger corporation that with the quality of community life.[6]

A void in community political leadership was created by the withdrawal of the business elite, except where a substantial number of plants remained locally owned.[7] Researchers not only viewed the loss of committed managerial elites as a decline in community welfare, but also recognized that communities were increasingly vulnerable to substantial changes in social and economic life resulting from decisions made by corporate elites located elsewhere. The shift in the ownership and control of capital from small local units with regional markets to nationally controlled larger units serving national markets reflected the increasing vertical integration of the American economy.[8] The developing national economic system created uncertainty for local community life, as local welfare became increasing intertwined with national economic trends.

Quality of Community Life

Though investigators conducting community case research bemoaned the loss of community control and the decline in industrial managers' political leadership, little serious comparative work in the relationship between the quality of community life and absentee control appeared until Mills and Ulmer's report to the Senate Small Business Committee in 1946.[9] Three two-city pairs were matched on population size and region, using cities where a minimum of 40 percent of the labor force was employed in manufacturing. Pairs were selected to contrast those cities having high degrees of concentration of employment in single industries versus those with wide dispersion across industries.

In each pair, one city had an overwhelming majority of workers employed by absentee owned companies. These cities were labeled "big business," as opposed to "small business" cities. In the largest pair, two midwest cities with 1940 populations of over 150,000, the proportions of employment in absentee owned firms were 96 percent in the big business city and 15 percent in the small business one. Small business cities had a lower average number of employees per firm and contained many more manufacturing establishments.

Civic welfare was examined through a series of bivariate analyses, producing an accounting of the apparent effects of absentee ownership and concentration of a local econoomy in a few industries. The "big business" cities had grown rapidly in the period of industrial consolidation, particularly from 1900-1930. The big business cities had greater fluctuations in employment levels (over the 1925-1939 period), average per worker wage tended to be lower (though wages in manufacturing and retail trades were higher), and the number of business establishments was lower and varied to a greater extent. Direct local comparisons also showed greater fluidity in real estate prices in "big business" cities as well as greater decay in downtown areas as companies moved to the suburbs.

Retail sales per capita were higher in each of the diversified "small business" cities than in its paired "big business" city. Consumers indicated that shopping areas in "big business" cities were not as attractive and they sought facilities with greater variety and better management. Merchants in the economically specialized absentee dominated cities argued that it was irrational to invest in more varied goods and new shops because of the uncertainty they faced as a result of the dominance of major employers. The distribution of income was also less highly stratified in the more diverse cities.

Use of Thorndike's G-scale of Civic Welfare [10] provided a variety of information on private welfare and public expenditures. The cities with high levels of absentee ownership had greater levels of crowding and higher infant mortality rates. Per capita expenditures on public recreation facilities and libraries were clearly lower, with health and education expenditures somewhat so. Utilities were more limited, church membership lower, and reading habits less varied.

Mills and Ulmer attributed the lower levels of civic welfare specifically to big business. The presence of large absentee owned firms reduced civic spirit, defined as "widespread participation in civic affairs on the part of those able to benefit a community by voluntary management of civic enterprises."[11] Such activity was traditionally the province of the independent middle-class small businessman. He benefited from contacts in government, community growth, and infrastructure investments. In contrast, the welfare of large corporations does not depend on personal local contacts. "There is no economic incentive for officials of absentee owned corporations to be someone civically."[12] In big business cities, the middle class tended to be salaried employees of the absentee corporations and the independent middle class was substantially reduced. Corporate executives topped the social prestige structure of the community but had little involvement with the "townfolk." The study also found that corporation executives were extremely powerful when local issues impinged on corporate interests. They could often exercise veto power in a political debate because of their economic domination of the city.

Despite the crude measures and deceptively simple conclusions, this study managed to identify the variables and issues which dominated the next three decades of community research. First, it suggested that the presence of absentee owned corporations directly affects community autonomy. Vulnerability to economic loss based on corporate decisions created community dependence upon the absentee owners. Absentee owners can then dominate local politics by direct intervention or by permitting local players to make political decisions anticipating corporate wishes. Plant locations, closures, or threats of closure created uncertain economic and social conditions which influenced both family and community life.

Second, the jobs provided by such corporations influence the private welfare of community members by altering wage distributions, employment patterns, educational requirements for jobs, occupational characteristics and land values. Third, absentee owned corporations influenced the demand for public services, including education, sanitation, welfare, etc. Their ability to dominate local politics implied that the issues raised and public outputs produced were especially responsive to corporate interests.

Finally, Mills and Ulmer provided a fourth issue which leads not only to concern over their findings but also to ambiguities in interpreting much of the data to be reviewed here. Their study described big business cities as those with (1) employment concentrations in one or at best a few industries _and_ (2) absentee ownership of local plants. Unfortunately, absentee ownership and economic diversity need not be highly correlated, as the Cornell Data Bank for Social Accounting shows. (In a sample of 300 non-metropolitan counties, economic diversity and the number of top-200 manufacturing firms are correlated -.11). By itself, functional specialization may produce vulnerability to economic downturns or political domination by particular industrial elites. Specialization is associated with differences in occupational, housing and educational characteristics[13] as well as levels of industrial conflict.[14]

A further complication in current research on absentee ownership arises from the clear bifurcation of research sites. Most community power studies have examined such large metropolitan areas or urban centers that tracing the impact of particular actors in the political and economic systems is impossible. Aggregation bias prevented the unambiguous interpretation of results. Thus, discovering that the number of absentee owned plants in a city is associated with a particular form of government or policy output leaves much to the viewer's interpretation. Research in rural settings enhances an investigator's ability to attribute outcomes to particular events, such as the construction and operation of an absentee owned plant, but questions of community power structure and political mobilization have seldom been the focus of such projects. Instead, income distribution, migration patterns, education, and age of the population receive attention. Overlap between metropolitan and non-metropolitan based studies comes only in the area of public expenditures.

Community Vulnerability

Absentee ownership created community vulnerability by (1) creating uncertainty regarding the stock of local jobs, and (2) by robbing the community of the skills needed to cope with economic crises. Further, local institutions lose their ability to respond to local needs. Job uncertainty is created by the corporation's calculus which produces plant openings and closings with minimal concern for their local consequences. Skills erode through corporate policies of selective withdrawal from the political arena and failure to provide assistance in attracting further industrial development. Centralized decisions made at corporate headquarters prevent local plant managers from responding to local situations.

Economic base theory makes community vulnerability quite clear. Jobs created or lost in the export sector of the economy have multiplier effects which alter the stock of non-basic jobs.[15] Job loss studies show that local labor markets do not efficiently absorb displaced workers[16] and effects are particularly severe in smaller, specialized communities.[17] The median duration of unemployment tends to be short, but the data also shows a large number of individuals who face long term unemployment.[18] Income losses are severe for particular categories of workers.[19] In addition to income loss, a number of studies show substantial social and physical effects, including reduced community cohesion, increased suicides, alcoholism and heart attacks.[20]

Job loss due to plant closings does not directly address the issue of absentee ownership, but a variety of studies suggest that some plant closings are a function of corporations excluding community welfare from their economic calculus. Frank and Freeman[21] attribute substantial job displacement to multinationals moving production facilities outside the U.S., even though the product produced was sold and consumed domestically. Others have documented miscalculation and mismanagement resulting in unnecessary plant closures by conglomerates.[22]

Explicit studies of the effects of absentee ownership on plant closures and job creation provide relatively clear results. Mergers between locally owned and conglomerate corporations in Wisconsin significantly decreased rates of growth in employment and payroll in the acquired firms. Use of non-local financial, legal and accounting services produced direct revenue losses to the community.[23] A similar pre merger-post merger study in Nebraska documented the same results.[24] Patterns of employment growth in Maine manufacturing in general and the shoe industry in particular show that locally-owned large firms increased employment by 82 percent (110 percent in shoe manufacturing) from 1958-1969, while the absentee owned company figures were 8 and -12 percent, respectively.[25] Work in rural Iowa confirms these patterns in showing greater stability of operations in locally owned firms.[26]

These studies do not lead to the conclusion that locally controlled business is economically more efficient or profitable. Rather, they suggest that conglomerate firms have greater capital mobility and access to resources. They can take advantage of locational opportunities to a greater degree than single plant companies. However, an acceptable rate of return to those with local capital is available. With equal access to resources, a firm committed to a local area might do just as well as the conglomerate, in addition to promoting local economic and social stability.

Absentee ownership created community vulnerability by decreasing the grass roots power base of local elites and increasing the power of locally based managers of national industries and corporations. The ascendence of absentee managers in local politics is well documented.[27] Schultz's analysis of Ypsilanti is particularly important because it showed the bifurcation of local power between economic dominants (from the absentee corporations) and public officials and leaders. City manager forms of government tended to have this characteristic. Clelland and Form[28] reexamined Schultz in a comparative context and showed that local economic elites began to withdraw from the local community domination during the period of industrial expansion and integration in the late nineteenth century. The managers of non-local corporations with outside professional and economic interests came to dominate local politics by defining and determining local community issues.[29] Controlling the definition of community issues and setting political agendas are crucial control mechanisms.[30]

The significance of domination by those with outside interest lies not only in shifting policy outputs, but also in the decline of a locally based leadership. Transient managers are poorly integrated into the community social systems and have difficulty responding to problems unrelated to corporate interests. If a plant shutdown should occur, the local talent required to meet the crisis or work on attracting new industry in unavailable. Absentee ownership created a leadership void and an absence of the organizational infrastructure required to mobilize the population.[31] Warren refered to this problem as a decline in "horizontal linkages" within a community, while Turk addressed the necessity of having an organizationally-rich environment.[32] Elite domination by those lacking a commitment to the community is thus asserted to decrease the ability of communities to cope with environmental change.

Centralized decision making robs local decision makers of their ability to solve local problems. Corporate headquarters place limits on the autonomy of local managers,with their lack of knowledge of the local social setting preventing them from settling local issues quickly. A clear case of centralization of decisions at the corporate level is the loss of control by plant managers over local labor relations. Kochan[33] showed that in multiplant bargaining, decisions concerning wage proposals, fringes, strike threats and final agreements are likely to be made at the corporate or division level rather than at particular plants. Of 668 corporations examined, only 1.1 percent gave local plant managers primary responsibility for final packages and only 4.7 percent had responsibility for wages. Berg suggested that similar centralization may be occurring on both the labor and management side in grievance handling.

In effect, dependence on absentee owned employers created community vulnerability to rapid economic and social change as well as a learned incapacity for community self-help. The corporate calculus of capital mobility does not include an assessment of local community welfare, putting local residents in the position of dependence upon decision-makers over whom they have no control.

Community Power and Community Outputs

Sociologists and political scientists pursued the issue of community domination by political and economic elites in several hundred studies of community power structures.[34] Initially the theoretical dispute focused upon the existence of two forms of local power structure. In one form, a relatively small elite controlled community politics by reducing citizen participation and access to the decision making process. This centralized, pyramidal power structure was contrasted with a second form in which the influential participants differed across decision areas and access was open to more participants. Unfortunately, scholarship became entangled in methodological controversy as different research strategies tended to identify different power structures.[35] The beneficiaries and outputs of community decision processes received scant attention in this work until researchers noticed that the speed with which new programs were adopted and the actual levels of expenditures for public services were related to the degree of centralization or decentralization of decision making structures.[36]

Among the earliest studies were some which questioned the findings of Mills and Ulmer. The general assumption that local managers of absentee cor-orations coalesced into a monolithic power elite was challenged, and results suggested that civic welfare was, perhaps, imporved by the input of well-educated corporate managers. Contradictory evidence was the norm in a variety of case study projects.[37] While one study would argue that managers of absentee owned corporations (AOCs) could defeat proposals simply by witholding support, another saw AOCs improving the quality of community life by increasing local occupational skill levels, property values, and the tax base. Different industries and variation in corporate policies regarding public involvement lead to differing results. Mott finally argued that the only certain proposition was that corporations would act to protect their own interests.[38]

Walton reanalyzed over 100 cases from this early research. He found strong support for the conclusion that communities with substantial numbers of AOCs have pluralistic or decentralized rather than monolithic or centralized local decision structures.[39] "Big business" is associated with more centers of power, wider access to the local political system and greater levels of citizen participation in local government. However, Aiken pointed out that dispersion also occurs in older cities, with large city governments and heterogeneous populations.[40] In large metropolitan areas, AOCs may simply represent additional interest groups which are mobilized on specific issues.

Debate over the relative effectiveness of centralized and decentralized decision structures has focused more explicitly on governmental outputs. Sharkansky[41] and others argued that decentralized decision making, particularly in the form of competing interest groups, increases public expenditures. Still others argued that centralized structures increased outputs through closer coordination of efforts. Decentralized power created too much fragmentation to promote timely decisions and thus decreased outputs.[42] Interorganizational theorists joined the debate by arguing for greater outputs when linkages between organizations were tighter, thereby producing needed coordination.[43] Clark[44] attempted to resolve the dabate by arguing that decentralized decision making is efficient when private, divisible goods are involved (e.g. patronage jobs; welfare; zoning) but centralized control efficiently produces public goods such as desegregation, floridation and urban renewal.

Such a formulation both reconciles contradictory findings and suggests an interpretation of AOC involvement in decision making. Mott's reanalysis of the Ypsilanti study argued for an "illusion of corporate inactivity" in which the corporation develops "new roles using new methods" to exert local influence.[45] By employing a substantial proportion of the population and carefully selecting public and private actions, AOCs can operate as a decision making interest group mobilizing resources when its interests are at stake. A study of Jones and Laughlin's involvement in community affairs in Hennepin, Illinois exposed this particular strategy. The company sometimes took unilateral actions to which the community simply responded. These actions included the use of "ghost" purchases to hold land prices down, hiring workers from outside the community, and helping transferred employees find housing in neighboring areas. Such tactics reduced the potential increase in population and land values which often accompanies a plant opening in a rural area. Second, the company coopted elements of the local population into the company by hiring local notables to handle personnel and public relations functions. Third, when forced by threat of community action which was not to its liking, the corporation directly intervened. Though J & L exercised considerable influence on local politics, the local population did not recognize J & L executives as community leaders.[46]

Some attention has been given to the effects of AOCs mobilizing resources to influence issues in metropolitan areas. Theoretically, the interorganizational linkages in a communite affect the capacity of the population to coordinate its activity in establishing programs such as urban renewal, increasing public expenditures, or expanding the scope of public services. Using an ecological approach to mobilization, Lincoln[47] measured absentee control by the proportion of a city's total labor force employed in branch plants of the 1000 largest U.S. corporations. Across the 110 central cities examined, he found absentee ownership negatively related to population size but positively related to manufacturing employment. Outputs in terms of scope of municipal government, municipal expenditures, poverty funding and urban renewal programs were all somewhat lower in relation to absentee ownership. The mechanism reducing outputs on three of these variables was reduced mobilization of the community. Having controlled for plant size, population, manufacturing and Hawley's MPO ratio, Lincoln concluded that "concentration (plant size) and absentee ownership are facets of the distribution of power and resources in the locality which are strongly dependent on city size and function (manufacturing) and have equally significant consequences for the distribution of managerial roles (the MPO ratio), the structure of city government and the level of urban policy making."[48]

The dual accounting systems of AOC and local community welfare are apparent in studies of community power structures reviewed above. AOCs represent a particular interest in the community and participate in local policy decision when their interests are involved. The resources available to them, as well as community economic dependence, give them considerable influence, and their selective application of these resources reduces the general level of public services provided by local governments. Whether private gains due to the location of AOCs compensate for lower per capita expenditures, or whether community welfare is actually reduced, is unclear. In metropolitan areas, the complex structure of the community and the aggregated level of data employed make conclusions concerning AOCs ambiguous at best.

Rural Industrialization

Plant location in non-metropolitan areas generates effects that are easier to document that AOC behavior in metropolitan areas. Affectionately termed the "Industrial Invasion of Rural America,"[49] movement of industry to rural areas occurs as a result of perceived locational advantages from the corporation's perspective. Labor, land and tax costs are lower than in metropolitan and other urban areas.[50] Non-metropolitan manufacturing employment grew 22 percent from 1960-1970 compared to 4 percent in metropolitan areas.[51] Small communities compete for industry, believing that industry provides the prospect of improved quality of community life. Many communities and some states offer locational subsidies and undertake infrastructural investments, such as new water districts and highway extensions, to accomodate prospective employers.[52] Federal policy has encouraged such movement to rural areas through the Public Works and Economic Development Act of 1965, the Appalachian Regional Development Act of 1965, the Rural Development Act of 1972, and the President's Task Force on Rural Development.[53] The Economic Development Administration expends considerable effort on this approach to local development.

Federal, State, and local municipal policy assumes that introducing new industry into a community improves the quality of local life and produces economic health. Rural residents may achieve equality with the standard of living of urban dwellers.[54] This extension of "growth is good" mentality of Ameican municipalities[55] has produced locational competition (in the form of tax subsidies and infrastructural investments) which may negate many of the presumed advantages.[56] Eberts, however, argued that industrial growth is associated with improved quality of social economic, political and health aspects of life.[57]

The local "growth machine" and absentee corporation perspectives reach similar conclusions in this case. The corporation reduces its costs by entering an uncluttered, undeveloped environment, while community residents reap the benefits of higher wages and non-agricultural employment. Summers argued that there is often an accompanying expectation of reduced rural poverty.

However, the corporate calculus implies greater long term effects. Corporate location decisions transformed U.S. urban structure by first creating cities and then deserting them for the suburbs. The move to rural areas represents a third stage in the transformation of urban places. The urban environments which industrialization created are no longer hospitable to it. Urban problems and labor militance caused industry to relocate to the subrubs in earlier stages of industrial development, and rural industrialization extends this practice.[58] Rural location often reduces firm labor problems and the corporate calculus often includes the belief that rural workers put in a full day's labor while urban workers are only concerned about job security and don't produce as much.[59] A Nebraska study of the factors affecting location decisions found that labor quality and labor availability were the first- and third-ranking reasons for site choices. Infrastructural and space considerations also ranked near the top. On a list of manufacturers' stated likes and dislikes about location in the state, the existence of a "right to work" law was the most frequently mentioned positive factor.[60] Labor control thus weighs heavily in the corporate calculus.

The welfare implications of rural industrialization, which almost always involves a location decision by an AOC, are easily traced, in comparison to the effects of AOC policies in metropolitan areas. In effect, quasi-experiments are created because communities once predominantly agricultural receive a stock of manufacturing jobs. Comparisons of pre- versus post-location community characteristics and comparisons between communities are readily made. The extensive literature on rural industrialization in both rural sociology and agricultural economics provides a more precise picture of the effects of AOCs on community life.

Private Sector - Employment, Income, and Income Distribution

The most sophisticated summary of the impacts of rural industrialization comes from Summers *et al*.'s analysis of 186 case study research documents examining 245 communities. The studies were originally carried out between 1945 and 1973.[61] A variety of empirical generalizations emerge from this secondary analysis and many of these issues have been followed up in further research.

Communities hope that industrial development will stem the tide of population loss which has plagued rural areas. Overwhelming evidence from the cases shows that the population trend is reversed. However, the reversal is initially a result of increased in-migration rather than a reduced outward flow of young people. Summers' own intensive work in Putnam County, Illinois, shows the reversal of a 25 year decline in population size,[62] and his review of a number of studies in other communities showed that about 30 percent of the workforce were migrants. Out migration is reduced, but this is a long-run rather than short-term consequence.

Employment effects are spread outside of host communities. Long distance commuting is a relatively common phenomena which alters the presumed benefits of plant location. Commuting workers are likely to spend funds elsewhere than in the immediate employing area. The result is that local employment multipliers are much lower than expected. Studies show a range from 1.0 (no additional jobs) to 1.68,[63] and Summers argues that on average, three new manufacturing jobs create one additional non-basic sector job.[64] These small effects are reduced further as regional shopping centers grow, leading to the stagnation of small town shopping areas rather than their expansion.[65] In addition, many industries purchase raw materials and professional services outside the local area.[66] A study of a locally owned furniture factory which purchased raw materials, supplies and services locally shows a greater multiplier effect.[67]

Overwhelming evidence shows that unemployment levels decline, but only slightly. The locally unemployed are not usually hired because they lack the required skills, in-migrants have greater educational and skill levels, and newcomers, particularly women, enter the labor force. Because of these hiring patterns, the local level of poverty may be unaffected. High wage, high skill industries are least likely to hire the disadvantaged.[68]

General findings concerning employment suggest that the opportunity structure improves. There is growth in managerial, clerical and service occupations, but the positive effects are smaller than anticipated.

Income effects have drawn the most attention and provide the least ambiguous results. Median family and personal income is clearly increased by the creation of industrial jobs. Researchers differ in attributing increases to the number of manufacturing firms[69] or the proportion of the labor force employed in manufacturing.[70] Examinations of increased local income streams relative to local subsidies produce estimates of annual benefit ranging from 900 percent down to 119 percent in a case which assumed the plant might fail after a few years.[71] Shaffer and Tweeten obtained personal income gain estimates ranging from nearly $16,000 over five years to $44,000 over twenty years.[72] The caveat that much of the income gain goes to those living outside the host community is still applicable, particularly if one municipality has provided a locational subsidy.[73]

Creation of industrial employment in rural areas reduces income inequality, but Summers showed that certain segments of the population sustain relative losses. Newcomers and local residents who are employed by the new factory gain the most. The elderly and minorities suffer in terms of relative distribution.[74] However, overall, income-equalizing effects occur.[75] Summers' intensive case study shows that the Jones & Laughlin factory produced greater equality in household incomes than than occurring in the comparison counties over the same time period.[76] Equality of income distribution in a community rests as heavily on the diversity of economic activity as it does on manufacturing alone.[77]

Private sector effects of the location of AOCs in rural areas seem largely positive. Population stabilizes or grows, educational levels of the population increase, per capita incomes increase and the distribution of income and status is somewhat equalized. Certain groups do not benefit from the reorganization of the occupational structure of the community. The persistence of rural poverty among certain groups somewhat mitigates these positive personal gains, and the issue is particularly difficult when such groups have partially paid for the industrial growth through municipal government.

Public Sector - Revenues and Expenditures

Gains and losses in the public sector are more difficult to weigh than in the private sector. Summers *et al.*'s review argues that the substantial increases which occur in the fiscal resource base of local municipalities are outweighed by increased demands and costs of services to the new industry and growing population, but other research indicates some gains in the revenue-expenditure balance.[78]

Local governments realize little of the property tax benefit available from new industry because tax breaks either totally or substantially reduce corporate obligations for up to fifteen years.[79] Summers marvels at the exceptional situation in which the 3M company paid over $160,000 in property taxes to Brookings, S.D. in 1973.[80] Given tax breaks, average tax payments range from $3,000 to $6,000 in the first few years.[81] Subsidies cost the municipality but produce private benefits for the corporation and local citizens. Revenues are also directly obtained for services provided (e.g. electricity), but these should be equal to the costs of such services.

Revenue increases are probably greater as a result of indirect effects. Industrial location increases property values in almost all cases.[82] Residential property is improved and new construction occurs, although new construction grows only in an initial burst which quickly subsides.[83] Construction is conditioned by the available stock of housing and the characteristics of the workers employed in the plant. Studies show that the assessed value of land increases as do total property tax revenues.[84]

Increased payroll produces increased retail sales to the extent that workers live and/or shop within the community. As a result, sales tax revenues also increase, but the effect of leakage due to income leaving the community is significant. Revenues also grow for service activities, such as building permits, and from intergovernmental transfers. The literature clearly supports a view that increased industrialization produces increased government revenue.

At the same time, costs of governmental activity increase substantially. Major expenses include land purchases for the corporation (often through municipal bond issues), loss or previous taxes from the new corporation's land, increased infrastructural investment, and greater fire and police protection. Municipal governments have often offered special utility rate structures which increase costs to the community. Substantial increases in local water and sewer service rates occur in some cases.[85] The population of school age children is accompanied by increased expenses for eduction. Per capita expenditures for infrastructure, police, fire, and education should increase.

On balance, the results are mixed. One study shows an average gain in the private sector of twelve communities of over $152,000 per year, but a school district gain of $401 and governmental gain of $521. In six of the twelve communities the municipal revenue balance was actually negative as a result of the plant location.[86]

Summers et al concluded that fiscal gains for municipalities are most likely where no subsidy was given for location in the community, mostly local workers were hired or large numbers of workers commute into town, eliminating the increased demands for services which accompany population growth. Skilled migrants from urban areas have been particularly vocal in demanding improved services from the community, and new corporations have an interest in assuring that such services are provided.

Community Vulnerability

Attracting AOCs to rural areas create several additional hazards. The interests of some community residents differ from those of the corporation and may be adversely affected by corporate action. Rural industrialization causes self employed agricultural workers to move to factory work. They then become dependent upon the factory's continued operation, particularly if farms are sold. Some evidence suggests that the total amount of farm land is not reduced by factory location, but the number of farms declines substantially. Should layoffs occur or the plant close, the farmers converted to factory work do not return to the farm. They become unemployed or must migrate.[87]

Heightened land values work to the disadvantage of local farm owners. Industrialization increases income to non-farm families, but may increase taxes to farmers due to increased valuations. There is no evidence that tax rates are actually reduced.[88] In effect land becomes a new commodity, used for agriculture but increased in value due to the proximity of commercial property. Dual taxation systems are required to protect remaining agricultural land.

The new corporate actor on the local political scene acts in its own interest as quietly as possible. Seiler and Summers show that Jones & Laughlin encouraged their executives to live in neighboring towns to hold down taxes on the plant. It intervened in a decision on a new school and pushed for zoning laws which reduced population growth near the plant. Yet throughout its involvement in local politics, the company remained politically invisible to most residents of the community.[39] Similar events occured in the relationship between the John Deere Co. and the city of Waterloo, Iowa. A corporation's calculus of private benefit may not coincide with long run welfare of host communities.

Conclusions

Summarizing the literature on absentee owned corporations' effects on local community welfare is a difficult task because of the contradictory social accounting schemes employed. From the perspective of a corporation charting its moves in a national economy, the ability to add or drop plants at will simply reflects the mobility of capital necessary in an efficient industrial system. From the perspective of local community residents, however, the free mobility of capital is a central factor in their heightened vulnerability to disruptive social, economic and political changes. This is not to say that rural communities--where the evidence is clearest--fight to prevent the invasion of absentee owned firms. Paradoxically, in view of the rather mixed picture we have presented of AOCs effects on public sector revenues and expenditures of non-metropolitan communities, local politicians often actively seek new industry.[90] This "growth machine" mentality may result from the well-documented private sector gains flowing from the industrialization of rural areas. Closer examination of the gains, however, shows that the benefits are rather unequally distributed across population subgroups, suggesting that contradictory calculations of welfare affects may occur within communities as well as between corporations and communities.

In metropolitan areas, community outputs are a result of a city's economic base and the nature of interorganizational coordination. Economic specialization heightens the power of large absentee owned firms, whereas their power is greatly reduced in economically diversified communities. AOCs, when powerful, can facilitate or hinder the mobilization of political resources and thereby influence the level of urban policy making. Separating the effects of economic diversification from the presence of AOCs is straightforward in large metropolitan areas, but the two are nearly inseparable in rural areas.

We have resisted any attempts at deriving a "balanced" picture of AOCs effects on local communities because we could find no neutral scale. How does one weigh increased per capita income against the loss of local political autonomy? Communities have been transformed by their incorporation into the national economy of multi-plant corporations, and through this process have inextricably linked their fates to national economic trends. Persons holding a fond memory of local community autonomy will look on the result as a tragic loss. Persons conceptualizing the process as an inevitable transformation through the rationalization of all social, economic, and political activities will simply not the passing of an era.

FOOTNOTES

1. Mancur Olson, Jr., Economics, Sociology and the Best of All Possible Worlds, 12 The Public Interest, 96, 1968. Joseph A. Schumpeter, Capitalism, Socialism and Democracy (3rd ed., 1950).

2. David Gordon, Capitalist Development and the History of American Cities, in Marxism and the Metropolis (1970). Alfred Chandler, The Visible Hand (1977).

3. William H. Form and Diebert Miller, Industry, 3 Labor and Community (1960).

4. Robert S. Lynd and Helen Merrell Lynd, Middletown (1929). W.L. Warner and Paul S. Lunt, The Social Life of the Modern Community (1941). W.L. Warner, Democracy in Jonesville (1949).

5. W. Lloyd Warner and J.O. Low, The Social System of the Modern Factory (1947).

6. Norton Long, The Corporation, Its Satellites, and the Local Community, in David Minar and Scott Greer, The Concept of Community, 163-176, 1969.

7. Irving A. Fowler, Local Industry Structures, Economic Power and Community Welfare: Thirty Small New York State Cities 1930-1950 (1964).

8. Roland Warren, The Community in America (2nd ed., 1972).

9. C. Wright Mills, and Melville J. Ulmer, Small Business and Civic Welfare. Report of the Small War Plants Corporation to the Special Committee to Study Problems of American Small Business. U.S. Senate, 79th Congress, 2nd session, Document Number 135. Serial No. 11036. Washington, D.C.: Government Printing Office, 1946.

10. E.L. Thorndike, Your City (1939).

11. Mills and Ulmer, at 22, supra.

12. Mills and Ulmer, at 23, supra.

13. Otis Duncan, W. Richard Scott, Stanley Lieberson, Beverly Duncan and Hal Winsborough, Metropolis and Region (1960).

14. Robert N. Stern, Intermetropolitan Patterns of Frequency, 29 Industrial and Labor Relations Review, 218, 1976. Omer Galle, Occupational Composition and the Metropolitan Hierarchy: The Inter- and Intra-Metropolitan Division of Labor 69 American Journal of Sociology, 260, 1963. Clark Kerr and Abraham Siegel, The Interindustry Propensity to Strike: An International Comparison, in Arthur Kornhauser, Robert Dubin and Arthur Ross (ed.), Industrial Conflict (1954).

15. Se-Hark Park, A Statistical Investigation of the Urban Employment Multiplier, 6 Mississippi Valley Journal of Business and Economics, 1, 10, 1970.

16. George P. Schultz and A.R. Webster, Strategies for the Displaced Worker (1966). William Haber, L.A. Ferman and J.R. Hudson, The Impact of Technological Change (Kalamazoo: W.E. Upjohn Institute, September 1963).

17. David Levinson, Displaced Pottery, Workers Adjustment to Layoff, Weathering Layoff in a Small Community, U.S. B.L.S. Bulletin No. 1516 (Washington: U.S. Government Printing Office, June, 1966).

18. Arlene Holen, Losses to Workers Displaced by Plant Closure or Layoff: A Survey of the Literature. (Arlington, VA: Center for Naval Analysis, November 1976).

19. Louis Jacobson and Janet Thomason, Earnings Loss Due to Displacement. Center for Naval Analyses 385 (August 1979).

20. Harvey Brenner, Estimating the Social Costs of National Economic Policy: Implications for Mental and Physical Health and Criminal Aggression in Achieving the Goals of the Employment Act of 1946. 30th Anniversary Review, Vol. 1, Paper No. 5. (Washington, D.C.: U.S. Government Printing Office, 1976). Walter G. Strange, Job Loss: A Psychosocial Study of Worker Reactions to a Plant-Closing in a Company Town in Southern Appalachia (Unpublished Cornell Dissertation, 1977). Sidney Cobb, Physiologic Changes in Men Whose Jobs Were Abolished, 18 Journal of Psychosomatic Research 245, (1974).

21. Robert Frank and R.T. Freeman, Multinational Corporations, Trading U.S. Jobs for Corporate Profit, 1975 Viewpoint, 16. Edward Kelly, Industrial Exodus. Public Strategies for Control of Runaway Plants. (Washington: Conference on Alternative State and Local Public Policies, October 1977).

22. Stephan Michelson, Community Based Development in Urban Areas. (Cambridge: C.C. E.D., October 14, 1977, mimeo).

23. Jon A. Udell, Social and Economic Consequences of the Merger Movement in Wisconsin. Wisconsin Economy Series, No. 3 (Madison: Graduate School of Business, May 1969).

24. Stanley Brue, Local Employment and Payroll Impacts of Corporate Mergers. 6 Growth and Change, 4,8 (1975).

25. Michael Booth, Ownership of Industry: The Maine Case. (Cambridge, Massachusetts: CCED, 1972).

26. David Barkley and Arnold Paulson, Patterns in the Openings and Closings of Manufacturing Plants in Rural Areas of Iowa, 1979.

27. Rolland Pelligri and Charles Coates, Absentee-owned Corporations and Community Power Structure. 61 American Journal of Sociology. 413 (1956). Robert Schulze, The Role of Economic Dominants in Community Power Structure. 23 American Sociology Review, 3 (1958). C.W. Mills and Melville Ulmer, supra, Note 11.

28. Donald A. Clelland and William H. Form, Economic Dominants and Community Power: A Comparative Analysis. 69 American Journal of Sociology. 511 (1964).

29. Arthur J. Vidich and Joseph Bensman, Small Town in Mass Society. (1958).

30. Peter Bachrach and Morton S. Abratz, Two Faces of Power. 56 American Political Science Review 947 (1962).

31. Robert N. Stern, K. Haydn Wood and Tove Helland Hammer, Employee Ownership in Plant Shutdowns: Prospects for Employment Stability. Report to W.E. Upjohn Institute for Employment Research, 1979.

32. Rolland L. Warren, supra Note, 8. Herman Turk, Organizations in Modern Life, (1977).

33. Tom Kochan, Collective Bargaining and Industrial Relations: From Theory to Policy and Practice, Chapter 6, to be published 1980.

34. Donald Clelland and William Form, Economic Dominants and Community Power: A Comparative Analysis, 69 American Journal of Sociology, 511 (1964). William H. Form and William V. DiAntonio, Integration and Cleavage Among Community Influentials in 2 Border Cities. 24 American Sociological Review, 804 (1959). Harris, Carl V., Political Power in Birmingham, 1871-1921 (Knoxville, University of Tennessee Press, 1977). Rolland Pellegrin and Charles Coates, Absentee Owned Corporations and Community Power Structure. 61 American Journal of Sociology, 413 (1956).

35. David Rogers, Community Political Systems. In Bert G. Swanson (ed.), Current Trends in Comparative Community Studies, (1962).

36. Terry Clark, Community Power. 1. Annual Review of Sociology, 271 (1975). Terry Clark, ed. Community Structure and Decision-Making: Comparative Analyses (1968).

37. Irving Fowler, Local Industrial Structures, Economic Power, and Community Welfare. 6 Social Problems, 41 (1958). Robert M. French, Change Comes to Cornucopia-Industry and the Community in Robert M. French (ed.), The Community: A Comparative Perspective (1968). Pellegrin and Coates, supra.Note 27.

38. Paul E. Mott, the Role of the Absentee-Owned Corporation in the Changing Community, in Michael Aiken and Paul E. Mott (ed.), The Structure of Community Power (New York: Random House, 1970).

39. John Walton, A Systematic Survey of Community Power Research in Michael Aiken, supra Note 38. John Walton, The Structural Bases of Political Change in Urban Communities. 43 Soc. Inquiry, 174 (1973).

40. Michael Aiken, in Michael Aiken, supra, Note 38, at 487.

41. I. Sharkansky, Ed, Policy Analyses in Political Science (1970).

42. D.J. Kirby, T.R. Harris, R.L. Crain, C.H. Rossell, Political Strategies in Northern School Desegretation (1973).

43. R. Warren, S. Rose, A. Bergunder, The Structure of Urban Reform (1974). H. Turk, Interorganizational Activation in Urban Communities. Washington, D.C.: Arnold and Caroline Rose Monograph Series, Am. Sociol. Assoc., 1973).

44. Terry Clark, Citizen Values, Power and Policy Outputs: A Model of Community Decision-Making. 4 J. Comp. Admin. 385 (1973). And Terry Clark, supra, Note 36.

45. Paul Mott in M. Aiken, supra, Note 38, at 170.

46. L.H. Seiler and G.F. Summers, Corporate Involvement in Community Affairs. 20 Sociol. Qterly. 375 (1979).

47. James R. Lincoln, Power and Mobilization in the Urban Community: Reconsidering the Ecological Approach. 41 American Sociol. Rev., 1, 1 (1976).

48. Id. at 13.

49. Gene F. Summers, Sharon D. Evans, Frank Clemente, E.M. Beck, Jon Minkoff, Industrial Invasion of Non-metropolitan America (1976). [Herinafter cited as Summers and Clemente].

50. Rural Industrialization: Prospects, Problems, Impacts and Methods. Papers Compiled by Sub-committee on Rural Development of the Committee on Agriculture and Forestry, U.S. Senate, 93rd Congress, 2nd session. (April 19, 1974). [Herinafter cited as Rural Industrialization].

51. Summers and Clemente, supra, Note 49.

52. Rural Industrialization, supra, Note 50.

53. President's Task Force on Rural Development. *A New Life for the Country*. Washington: Gov't Prtg. Office, March, 1970.

54. Gene F. Summers, in Rural Industrialization, supra, Note 50, at 9.

55. Harvy Molotch, The City as a Growth Machine, 82, American J. of Sociol., 309 (1976).

56. Don Stillwell, The Devasting Impact of Plant Relocations, 6 Working Papers for a New Society, 42, 1978.

57. Paul Eberts, Growth and the Quality of Life: Some Logical and Methodical Issues in Gene Summers and Arne Selvik, Non-metropolitan Industrial Growth and Change, 159-184, (1979).

58. David M. Gordon, Capitalist Development and the History of American Cities, in William Tabb and Larry Sawers, Marxism and the Metropolis (1978).

59. Maurice Fulton, Industry's Viewpoint of Rural Areas, in Rural Industrialization, supra, Note 50 at 73.

60. Corporate and Community Decision-Making for Locating Industry, Statement of Robert Shively, in Rural Industrialization, supra, Note 50 at 91.

61. Corporate and Community Decision-Making for Locating Industry, Statement of Robert Shively, in Rural Industrialization, supra, Note 49, at 91.

62. Summers and Clemente, supra, Note 49, Chapter 4.

63. Gene F. Summers in Rural Industrialization, supra, Note 49, at 12.

64. Gene F. Summers and Jean M. Lang, Bringing Jobs to People: Does it Pay? 7 Small Town, 3, 4, (1976).

65. Gene F. Summers, Rural Industry: Myth and Reality. 34 Social Impact Assessment, 4 (Oct. 1978).

66. Summers and Clemente, supra, Note 49.

67. Gene F. Summers and Jean M. Lang, supra, Note 64.

68. Stern, Wood, and Hammer, supra, Note 31.

69. Summer and Clemente, supra, Note 49.

70. Gene F. Summers, E.M. Beck, and C. Matthew Snipp, Coping with Industrialization, in Richard Lonsdale and H.L. Sayler (ed.), Nonmetro-Industrialization (1979).

71. David L. Rogers, et. al., Industrialization, Income Benefits, and the Rural Community. 43 Rural Sociology, 2, 250 (1978).

72. Donald R. Saltzman, Economic Case Studies of Community Sponsored Efforts to Develop Industry, Small Business Administration, Agt. Research Summary MRS-205, Tulsa Univ. Dept. of Comm. and Ind., April, 1964.

73. Ron Shaffer and Luther Tweeten, Net Economic Impact of New Industry on Rural Communities with Emphasis on the Cost of Industrialization, 1972 Western Agric. Econ. Assoc. Preceedings, 203.

74. Id. 204.

75. H.A. Wadsworth, J.M. Conrad, Impact of New Industry on a Rural Community. Ind. Agric. Exp. Sta. Bull. No. 811. (1966).

76. Gene F. Summers and Frank Clemente, Industrial Development, Income Distribution, And Public Policy. 41 Rural Sociology, 2, 248 (1976).

77. Brady J. Deaton and Maurice R. Landes, Rural Industrialization and the Changing Distribution of Fmaily Incomes. 1978 Amer. J. of Agr. Econ., 950. D. Rogers *et al.* supra, Note

78. Elwood M. Beck, Louis E. Dotson, and Gene F. Summers, Effects of Industrial Development on Heads of Households. 4 Growth and Change, 16 (1973).

79. Michael D. Betz, The City as a System Generating Income Inequality, 51, Social Forces, 192 (1972).

80. Summers and Clemente, supra, Note 49.

81. Summers and Lang, supra, Note 64.

82. Dwight G. Ulrich, Economic Impact of New Industry on the Brookings Community: 3M; A Cast Study. Masters Thesis, South Dakota State Univ. in Summers and Clemente, supra, Note 49.

83. Summers and Clemente, supra, Note 49.

84. Id. at 91.

85. Gene F. Summers in Rural Industrialization, supra, Note 50, at 9.

86. Summers and Lang, supra, Note 64.

87. Summers and Clemente, supra, Note 49.

88. Shaffer and Tweeton, supra, Note 73.

89. Gene F. Summers, in Rural Industrialization, supra, Note 50, at 9.

90. Summers and Clemente, supra, Note 49.

91. Seiler and Summers, supra, Note 46.

92. Harvey Molotch, supra, Note 55.

APPENDIX R.—MATERIAL SUBMITTED BY KEN ROOT; RE STUDY OF THE MASON CITY, IOWA, ARMOUR PLANT CLOSING

LUTHER COLLEGE
DECORAH, IOWA 52101

DEPARTMENT OF SOCIOLOGY, ANTHROPOLOGY, AND SOCIAL WORK

November 1, 1979

Mr. Mark Levine
Small Business Committee
B363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Levine:

Enclosed please find one paper on the Mason City Armour closure; unfortunately the piece that would serve your purposes best is still in the workup stage here, but I'm hopeful of finishing that in early 1980. There are other papers which I've completed on the Mason City project, but they simply are not in line with your goals, so I have not included them.

You might be interested in another piece, and that is the Eleen and Bernadine report on Canadian Shutdowns. They make a major point of Canadian shutdowns being made by owners from the U.S. and are of course not local people. Although a Canadian piece, I think you would find it of value as a reference tool. The complete reference:

Eleen, John W., and Ashley G. Bernardine. 1971. Shutdown: The Impact of Plant Shutdown, Extensive Employment Terminations and Layoffs on the Workers in the Community. Ontario Federation of Labour, CLC: Research Department, August.

As well, I can remember interviewing displaced Armour workers from Mason City who described the changed atmosphere (as they perceived it) once Armour took over, and then again once Greyhound became involved. Some workers would make a strong statement against Greyhound ownership. You might want to include a worker perspective in your hearings, perhaps the most objective being a sampling or representation from all sides.

I'm hopeful some of this material will assist you in your assessment of conglomorate mergers and their impacts on communities.

Best regards,

Ken Root

Kenneth A. Root, Ph.D.
Assoc. Professor

KAR/ser

"THE PLANT'S CLOSING, WHAT ARE WE GOING TO DO?": WORKER AND FAMILY RESPONSE TO JOB DISPLACEMENT*

Kenneth A. Root and Roger L. Mayland**

PREPARED FOR THE 1978 ANNUAL MEETING OF THE NATIONAL COUNCIL ON FAMILY RELATIONS: FAMILY ACTION SESSION, PHILADELPHIA, PA., OCT. 19-22, 1978.

ABSTRACT: Longitudinal data from blue-collar workers whose jobs were terminated in a plant closure, and completed interviews with their wives/husbands, provide the data base for assessing familiar response to a shutdown. Decision-making, subjective evaluations, and the perceptions of family and non-family alike are described, with the authors concluding that adjustment to displacement is more than financial, and significantly involves the family. The alternatives to termination available to these displaced workers, their evident family cohesion, and the societal environment in which they are emersed provide for a considerably different worker-family adjustment than we understand from the Depression-era classics.

INTRODUCTION:

As the United States continues to experience a downturn in the unemployment rate, attention has been shifting to plant shutdowns and large lay-offs. This displacement may be due to technological change, declining consumer demand, competition with foreign labor/products, or failure of a given company to acquire federal contracts. For whatever reasons, job loss caused by closure fortifies the unemployment rate by counterbalancing the gains in employment which might have been made by government programs, contract negotiations, or growth in selective industries.

---

*Funds for the earlier stages of data collection and initial analysis were provided by The State of Iowa, Office for Planning and Programming, Contracts 19-5-050-1002-11 and 19-5-050-1002-25. Funds for the fourth interview and analysis were provided by the North Central Regional Center for Rural Development, with additional funds provided by The State of Iowa, Department of Social Services.

**Kenneth A. Root is an Associate Professor at Luther College, Decorah, Iowa. Roger L. Mayland is a graduate of Luther College and is presently a free-lance social science interviewer and field-work consultant.

Unemployment generally, and plant closings specifically, are not new phenomena in this society, but as topics of social concern, they appear to be regaining attention from media, legislators, and the general public. Put in other words, job displacement, as one segment of the larger unemployment picture, appears again to be surfacing as a major social problem in the United States.

Many of us, as either teachers or students, may remember when social problems texts discussed job loss in the following way:

> Different as the modern worker is from his predecessor, he shares with him the terrible, haunting fear of unemployment. In a society where personality is organized around work, where a worker depends on his job for his very ties to the world, where his ability to perform his role as provider in the family rests on his job, anything that threatens that job is a catastrophe, not only economically but almost every other way as well.
>
> Numerous studies by economists and sociologists have documented the tremendous dependence of workers on their jobs to give meaning to their lives. Take away a man's work and he feels isolated, frustrated, lost. His personality becomes disturbed. He loses "face" with his wife and children, no matter how hard they may try to protect him, especially if they can and do get jobs. Family relationships become strained. If unemployment lasts a long time, bills pile up. Mortgages fall due. Installment payments cannot be made. Stress factors accumulate. The man's status rapidly deteriorates. (Bernard, 479)

Some of us might have personally witnessed the Depression, which provided the background for the above quote, or been a part of that number caught in the vise of Depression unemployment. For those who were neither participants, nor academics who read summaries, the classics are still there. These displacement classics, from a sociological perspective, are not vintage books confined to a particular era but are from at least three time periods.

The earliest time job loss was thoroughly reflected in the social science literature in the United States, goes back to the Depression, to the works of Angell (1936), Eisenberg and Lazarsfeld (1938), Komarovsky (1940), and Bakke (1940). Although these studies were comprised of small samples, they were important in initiating serious sociological attention to the status change and attendant role

Continued on
next page.

behavior of the unemployed. Moreover, these same studies have become role models for subsequent research, and not infrequently cited as appropriate for what might happen to today's worker who is confronted with job loss.

Unemployment and job loss were less in focus in the 1950's than in the preceding decade. The social science approach of the '50's appears to have emphasized an understanding of the social stress confronting families, and the contributions of Hill (1958) and Koos (1954) emphasizing unemployment as one such stress remain important contributions.

The unemployment literature of the 1960's largely centered on displacement, although economic growth and relatively low unemployment rates minimized the societal concern. Studies by Ferman (1963), and Palen and Fahey (1968), and additional titles completed during this decade support the continued stress under which the unemployed and in particular the older unemployed worker, were pressed. Sheppard, Ferman, and Faber wrote: Too Old to Work--Too Young to Retire: A Case Study of a Permanent Plant Shutdown (1960) while the title of Wilcock and Franke's study of five plant closings was Unwanted Workers (1963).

How relevant are these studies, some only a decade old? Have social and economic conditions within the larger society changed so that behavioral response to job loss is different from earlier time periods? Are there any indications that cultural values or societal norms regarding employment or unemployment have changed over time? These are some of the questions which lie behind this study, and to which we want to speak.

One caution: Keep in mind that this plant closing may not be universally typical or societally modal, in part because the closing of one plant in a multi-plant corporation allows for some workers to transfer (based on seniority), and because in this instance, the Company announced it would build a new plant in the same community seven (7) months after the old plant had closed. Since the new plant was being considered "within the area" at the time of closure, a lay-off option was available to still other workers.

THE STUDY

In February, 1975, Armour & Company announced it would close its Mason City, Iowa, plant in mid-August, 1975. The initial study plan was to draw a weighted, stratified sample of family units from almost 1100 bargaining unit employees at Armour, but a major difficulty was encountered when neither the Company would provide a roster of their married employees nor would the local Union provide a checkoff list of Union members. Since demographic characteristics were therefore not available, we were forced to use a seniority roster which had been provided to the Mayor's Task Force Committee by the Company. From this roster we drew a 10 percent systematic random sample, which yielded a sample of 103 respondents.

To assess worker and family response to the shutdown, we collected data from the worker and spouse during four time periods. The first interview was completed in July and August of 1975, just prior to the plant closing. Included in that interview schedule were: recall questions about how family members felt and behaved when they first learned that Armour was closing down, demographic characteristics, as well as indicators of marital satisfaction, mental health, and work satisfaction.

During the first interview, data were collected via use of pairs of male-female interviewers, and it was typical in our initial study to have the female interviewer conduct the interview with the male respondent and vice-versa. The worker interview (N=89 M & 7F) was a structured interview, while the spouse interview (N=5 M & 57F) was a focused interview which was tape recorded.

We had anticipated that most workers would stay on with the Armour Company until the closing had actually taken place since the union-management contract provided that bargaining unit employees who wish to receive separation pay, retirement benefits, or exercise transfer rights, must remain with the company until the actual plant closing. Such a contract encouraged workers to remain within

Mason City until the time of the actual closing, and this was the case among workers in our sample. In only two instances did workers drawn in the sample actually leave Armour prior to the plant closing.

Data from the displaced workers were collected again during the latter part of March, 1976. The March data collection was a personal interview with those workers in the sample who were still in the Mason City area. There were 77 of the original 103 in the sample and 71 of the 77 were interviewed. At this interview, we asked workers about their present work or non-work situation, their financial condition, and numerous attitudinal items measuring anomia, sex-role orientation, and husband-wife power relationships.

Shortly after the March data were collected, Armour announced it would build a new meat processing plant in Mason City. Although some of the plant operations would change and not all of the same jobs would be available, this facility would employ 350 workers and was expected to be ready for operation in late 1977.

In August, 1976, we again collected data from families in the sample. Only this time we again interviewed spouses (and only the spouses) of the displaced workers. An extensive interview was developed which solicited information on the work or job-seeking behavior of herself, her husband and other family members, parental relationships with children, and the spouse's preceptions of role behaviors and adjustments of family members. In this August interview, the number of displaced workers who were married or whose marriages were still intact was reduced to only 48. Of those 48 families, we were able to interview the spouse in 41.*

---

*At the first interview we completed 95 of the 103 drawn. Seventy four (74) of these workers were married, 7 separated or divorced, 2 widowed, and 12 single. At the second interview 77 of the 95 were still in Mason City or the surrounding area, and we completed interviews with 71. At the third interview we wanted to interview the spouse and were confined again to interview in the Mason City area. At this third interview, we completed 41 of the 48 possible interviews. The decline in sample from the second to third interviews is accounted for by the spouse interview, eliminating single, divorced/separated, and widows (there were 5 additional divorces/separations as well as one additional widow during this time), and also because transfers were now completed for those Mason City workers who had rights to work in another plant in the Armour chain.

A fourth and final interview with all workers was completed from mid-September until the end of October, 1977. For married workers, spouses were involved in the personal interview at the same time, with a single interviewer. Portions of these interviews were taped. Although the majority of the respondents remained in the North Iowa area, thereby facilitating personal interviews, cost factors limited personal access to transferred workers in Texas, Oregon, and Washington. These workers, and other difficult - to - complete respondents were contacted via telephone and serial interviews completed with worker and spouse. Transfers to Armour facilities located in Minnesota, Nebraska and elsewhere in Iowa were personally interviewed.

During this fourth interview, data collection emphasis focused on adjustment to the shutdown, including: (a) identifying networks of assistance of relatives, friends, and clergy; (b) assessing solidarity of family members; and (c) asking what special problems or benefits the family has had as a result of the closing.

Of the original sample of 103 (one worker and spouse had died), 86 or 81 percent were located and interviewed. In four instances, spouses did not participate in this fourth interview, but generally family participation was cooperative, and open. Considering that this was the fourth interview with some families over the two-and-a-half (2½) year period, and none of the respondents received compensation at any time, we believe the completion rate is acceptable.

FINDINGS:

In overview, we want to document the multi-faceted aspects of displacement which confront the families of terminated workers. The following components are the ones we want to describe today:

1. Response is decisional; options available to all workers involved in a closing are not the same, and selectivity of options must be made.
2. Response is subjectively judgmental; workers were asked: "For you and your family, would you say the plant closing was generally good, or generally bad?"

3. Response is perceptual; spouse views about the importance of work to her husband provide an indication of the thrust of job-seeking behavior.
4. Response is behavioral, with changes or maintenance of interaction with relatives a signal of how good a response the family is making to job loss, although the network may actually minimize negative impacts for the displaced family.

and 5. Response is status maintenance; being concerned with one's status placement by continual evaluation of the family's position within the community.

Assessments of these five facets may provide some clues to determining whether job loss today is much like that of earlier periods.

1. RESPONSE IS DECISIONAL. Confronting the worker in a plant closing may be the option of transfer with the same employer. Likewise, retirement and separation pay are frequent alternatives. In this plant closure, two additional options became available when Armour announced it would build a new plant in the area. These options included a lay-off status pending completion of the replacement plant and employment in that plant when it was operational, as well as a temporary transfer, with a right and obligation to transfer back to the new replacement plant when it was operational. The former temporarily "cut free" the worker from Armour, and the worker was neither paid by the company nor continued in insurance and health care fringes. The temporary transfer required a move for the worker with/without his/her family but continued salary, fringes, and time increment on seniority.

Not everyone has the years of service or requisite age to retire, nor sufficient seniority to transfer, and for some workers the choices were limited. For others, several options were available. Table 1 indicates that choice selection varied in a non-random manner for workers in the sample, as well as for the total bargaining-unit work force at the Mason City plant. Thus, in contrast to the Depression, and the closing of entire multi-plant corporations

TABLE 1

FREQUENCY AND PERCENT OF OPTIONS SELECTED BY SAMPLE, AND TOTAL ARMOUR WORK FORCE

	Sample		Total Work Force	
	N	%	N	%
Severance	29	28	322	30
Retirement	13	13	139	13
Transfer	9	9	145	14
Temporary Transfer	17	16	197	18
Lay-off	32	31	227	21
No rights	3	3	44	4
Total	103	100	1074	100

studied during the 1960's, options available today to workers in a plant closing may have increased substantially.

However, the decision of which option to select was difficult for some workers, and interviewers in this project occasionally found that a worker or family member questioned the decision they made almost three years earlier. The difficulty of decision making is reflected also in the fact that at least three (3) workers in the sample changed their mind, and renegotiated their options with the company. All three were temporary transfers, and one (1) elected severance, while the remaining two (2) selected the layoff status. Table 2 indicates that if workers (interviewed at T4, just over two years after the closure) were free to make a different choice about their option, 38 percent would elect to do so. Much of that shift comes from workers who separated from the company, but on a second thought, would have taken the layoff option.

2. RESPONSE IS SUBJECTIVELY JUDGMENTAL. As we did earlier, we asked workers at the fourth interview a question about whether they perceived the closing as generally good or bad. The question was phrased this way: "Regarding your family and the plant closing, would you say that the closing was generally good for your family or generally bad for your family?" The follow-up question was "That's interesting. Would you mind telling me why you answered that way?" Most of the respondents (40 percent) indicated that the closing was generally good for their families, although 30 percent said the closing was bad. An additional 23 (27 percent) provided a neutral response of both good and bad or neither good nor bad, and 2 workers (2 percent) indicated that the outcome of the closing was still to be determined.

Among those 35 workers who indicated the plant closing was good, the modal category were those who saw the plant closing as an opportunity. Bjorn Thompson, who had worked at Armour almost eight years, put it this way.

> I had always wanted to get out of Armour, to try something else--the closing allowed me to do that.

Others thought the plant closing was good for their families because it pro-

TABLE 2

CROSS-TABULATIONS OF OPTION SELECTED WITH "REDOING OPTION, ASSUMING YOU COULD"*

	Option Selected				
Redoing Option	Severance	Retirement	Transfer	Temporary Transfer	Lay-off
Severance	9	-	-	1	2
Retirement	-	9	-	-	-
Transfer	3	-	3	2	1
Temporary Transfer	3	-	3	10	2
Lay-off	12	2	-	2	22

* The questions asked were: "The union and Armour worked out some options on what you could do. Would you look at this card and tell me which option you took." and "Thinking back on it, which option would you take (assuming you could)?"

vided a valuable learning experience, or, for still others, an opportunity to move. Relief from stress, an opportunity to expand their interests were other response categories and for those selecting the lay-off, some even indicated that work in the new plant was a benefit. They viewed working in a new plant as a plus, because they would be assured of work for many years into the future, and because others had retired they would be elevated to status of "most seniority."

When we ran crosstabs of the closing option selected with judgment of the plant closing as good or bad, we found that each category had respondents who judged the plant closing as good or bad, although the temporary transfers were the most likely to indicate the closing was generally bad. In both the transfer and temporary transfer categories, few respondents selected both good/bad; apparently the outcome was clear in one direction or the other. For these same two categories, it is interesting that there were "bad" results, for they had full-time work with Armour, and they were building seniority. Their responses may be more indicative of non-financial impacts of a plant closing, including temporary adjustments or the forced termination of kin and friends in Mason City.

Another crosstab run, this time between the judgment of the plant closing and length of unemployment was made to see if only those with long periods of unemployment perceived the closing as "bad". Table 3 shows that equally as many of those workers with a short duration of unemployment (less than one month) perceived the closing as generally bad as good, and more of the long-term unemployed (one year or more) indicated that the plant closing was good than bad. Although there are no comparable data from displaced workers in the Depression or the 1950's or 1960's that we are aware of, we would not assume such results from the available literature.

TABLE 3

LENGTH OF UNEMPLOYMENT AND RESPONSE TO WHETHER THE SHUTDOWN WAS GENERALLY GOOD OR GENERALLY BAD

	Judgmental Response			
Length of Unemployment	Generally Good	Generally Bad	Both Good and Bad	Yet Determined
Less than 1 month	2	3	3	-
1-6 months	7	6	6	1
6-12 months	7	7	5	-
1 year or more	9	6	3	1

3. RESPONSE IS PERCEPTUAL. During the third interview with spouses only, we asked two questions about the worker's self-esteem. One, a follow-up question to the (at that time) employment/unemployment position of the worker, was: "What would happen to your husband's self-esteem if he were unemployed?" and a later question asked: "Do you think that working and being the breadwinner is important to your husband? From 1-10 with 10 very important, where do you think your husband fits on that scale?" At this interview, 15 of the women responded that unemployment would not bother their husband's self-esteem, while 21 indicated that his self-esteem would go down or he would in some way be negatively effected. In response to the latter question however, 34 of the 36 women indicated that they perceived working and being the breadwinner as important to their husband. Twenty-eight placed their husbands at the 9-10 score end of the continuum, and no woman gave her husband a score less than 6.

Then, at the most recent data collection stage, we asked this question of the couple:

> "Many years ago--during the Depression--studies of long term unemployed men suggested that the husband lost respect because he was unemployed. This was reflected in increasing marital conflicts, blaming the husband for unemployment, constant nagging, sharp criticism in front of the children, and so on. How is it with you folks, do either of you believe the husband has lost respect since the plant closing?"

In only four instances did we get a positive response to this question, while 62 workers and their spouse said no. There appears to be little question that at an earlier interview spouses viewed work as important to their husbands, but only a small number actually perceived present loss-of-respect, some months after the closing. To explain this apparent discrepency several alternatives are possible:

(1) Many workers had little difficulty finding employment and the rapidity with which these workers had in getting back into the work system provides different responses than the results of earlier displacement studies;

(2) it may be that the length of unemployment was not "long enough" to cause financial problems for the family and status-role change for the worker;

(3) adjustments within the family allowed the loss to be compensated for early in the closing aftermath and no longer posed family strains; and/or

(4) the plant closing was not "blamed" on the worker since as we not infrequently heard, "well, no, I haven't lost respect--it wasn't my fault."

We believe there is support for all four options, and these alternatives, independently or collectively, reinforce a view of adjustment to a shutdown, not a view of continued crisis. Further analyses of these data, and future studies, may help us even more understand the dynamics of how job loss is perceived.

4. RESPONSE IS BEHAVIORAL. There is an extensive literature on the importance of extended kin in the family, and we were interested in the role the modified extended family played in both "normal" supportive behavior, as well as in a time of "anticipated crises." One question we asked at all four time frames was:

> "Sometimes family and relatives are close and help each other in many ways--financial loans or baby-sitting are two examples. For you and your family/relatives, have there been such exchanges of help since the closing?"

Over the four time periods we found that 48 of the respondents consistently replied positively, while only 7 workers/families indicated a consistent negative response. Six (6) workers/families indicated there had not been exchanges, but there were now, and a rather startling 26 situations were cases of an earlier type of help, and none at present. A significant number of the families who had participated in reciprocal exchanges, but were not now involved had opted to transfer, or elected a temporary transfer and were no longer in easy physical proximity to continue the help exchange. Although no intensive analysis of help patterns has yet been completed with these data, they do reflect variable response to the situation/proximity of the families.

Help patterns or kin contact were significant to the workers, as noted in two different kinds of responses: Glenn Daugherty found a steady, good paying job in Mason City after being unemployed three weeks, and both Glenn and his wife Verna believe the plant closing was good for them. When I asked them about their ties to Mason City, even in the face of persistent unemployment, the Daugherty's were able to describe the kind of adjustments they might have to make under those conditions, including moving in with relatives, but the alternative of leaving Mason City for employment elsewhere was repeatedly denied. Although there were several reasons for staying in Mason City, one was voiced over and again: "We like our parents and relations--they're more important than money and a new and different job. Both of our families are here."

Cliff Johnson has a job in another community, while his family continues to reside in Mason City, and he commutes home every weekend. During the course of our lengthy interviews, I asked Cliff if either his or his wife's relatives had been helpful since the closing. His response was: "They kind of turned their heads." He went on: "So like I say I don't hold grudges but it's something I just don't want to think about. I went down to see them whenever anything needed to be fixed or anything needed to be done. I was always there. Even if I had something else to do, I never said no. When the chips were down like they were for us, we needed help, there was no one. I'm sure one day they will realize what they did to us when we needed them the worst."

5. RESPONSE IS STATUS MAINTENANCE. Being concerned with one's place within the community was anticipated as an important element in the response of displaced workers. Whether for status maintenance or meeting financial obligations, the most frequent negative outcome or problem presented by the closing was financial or indirectly financial, when respondents indicated their loss of fringe benefits.

Fringes were an important item since the Armour health care package covered all medical and dental bills for the worker and his/her family, plus all prescriptions, minus the first dollar for each prescription, and workers were now painfully aware of the cost of these benefits.

How have the workers fared financially over the three (3) year period since the plant closing? Table 4 shows the comparision of total family income at an earlier period, with the most recent interview, indicating that most workers lost significant slices of income, with the modal group of 21 who lost as much as $4000.00 of annual family income, and an additional 17 families who lost as much as $6000.00 annual income. Families adjusted to this financial loss with cutbacks in expenditures, use of savings, separation pay (if they severed with the Company), as well as having another person in the family go to work. Although 20 workers had a spouse already working full-time prior to the plant closing,and another 2 who were working part-time started working full-time after the announcement, 22 workers had other family members entering the labor market after the announcement, although some did not go to work immediately. This latter group comprised the new workers, and included 20 wives, and in two instances, children of workers who remained at home and went to work, rather than attend school.

TABLE 4

COMPARISON OF PRESENT EARNINGS WITH PRIOR EARNINGS

	Present Earnings						
Prior Earnings	-$5000	$5000- $7000	$7000- $9000	$ 9000- $11000	$11000- $13000	$13000- $15000	$15000
$15000	1	2	2	1	4	6	9
$15000 $13000-	1	1	2	3	-	3	3
$13000 $11000-	4	2	-	-	1	-	2
$11000 $ 9000-	1	3	2	1	2	-	-
$9000 $7000-	1	-	2	1	-	-	-
$7000 $5000-	2	-	-	-	-	-	-
-$5000	-	-	-	-	-	-	1

Lost income--as much as $6000

Lost income--as much as $4000

Stable income

Increased income--up to $4000

Increased income--up to $6000

SUMMARY AND CONCLUSIONS: With data collected at several different time periods from a sample of workers involved in the Mason City, Iowa Armour plant closing of August 1975, we've attempted to describe some of the components of worker and family response to the shutdown. Bargaining-unit workers confronted with a plant shutdown need to make decisions about their future, continually make judgments about whether the closing was good for them or not, perceive spouse response to the closing and act accordingly, attempt to maintain their extended-kin interaction, and insofar as possible, preserve their status within the community. Job loss due to displacement impacts more broadly than financial concerns, and significantly involves the family, not only the worker.

Noting increased options available to workers at this time in a multi-plant corporation, impacts, and responses, appear to be much different from studies of closings done in the 1960's, as well as those major works completed during the Depression. Most displaced workers in this study indicated the plant closing was generally good for their families, even though initial perception of the spouse indicated that employment for the male was significant in maintaining his self-concept. It is only suggestive that career shifts within the larger society are also considered viable options (not always as a forced choice) for displaced blue-collar workers. Extended kin contact continued to be important for many workers, including some who elected not to transfer because of familial involvement. In other instances, workers may have desired continued reciprocal kin contact, but found they had actually lost that exchange. For some of these workers, there were expressions of bitterness.

Status maintenance was evident in the large number of spouses (wives)who went to work at some point in time after the announcement to close the plant. The conditions facilitating spouse employment are uniquely available now, and are an important source of minimizing financial loss, a situation less apparent to workers displaced but a decade ago.

REFERENCES

Angell, Robert Cooley
1936 The Family Encounters the Depression. New York: Charles Scribner's Sons.

Bakke, E. Wight
1940 Citizens Without Work. New Haven, Connecticut: Yale University Press.

Bernard, Jessie
1957 Social Problems at Midcentury: Role, Status, and Stress in a Context of Abundance. New York: Dryden Press.

Centers, Richard
1961 The Psychology of Social Classes. New York: Russell and Russell.

Eisenberg, Philip and Paul F. Lazarsfeld
1938 "The Psychological Effects of Unemployment." Psychological Bulletin 35 (June): 358-391.

Ferman, Louis A. and Michael Aiken
1964 "Sociological Perspectives in Unemployment Research." Blue-Collar World, ed. Arthur Shostak. Englewood Cliffs, N.J.: Prentice-Hall.

Franklin, William B.
1977 "Business Outlook." Business Week, December 19, 1977: 19-20.

Hill, Reuben
1949 Families Under Stress. New York: Harper and Row.

Komarovsky, Mirra
1940 The Unemployed Man and His Family. New York: Dryden Press.

Koss, Earl L.
1950 "Class Differences in Family Reactions to Crisis." Marriage and Family Living, Vol. XII, 3:77-78

Little, Craig B.
1976 "Technical-Professional Unemployment: Middle-Class Adaptability to Personal Crises." The Sociological Quarterly, 17 (Spring): 262-274.

Moy, Joyanna and Constance Sorrentino
1977 "An Analysis of Unemployment in Nine Industrial Countries." Monthly Labor Review, (April): 12-24.

Palen, J. John and Frank J. Fahey
1968 "Unemployment and Reemployment Success: An Analysis of the Studebaker Shutdown." Industrial and Labor Relations Review 21 (January): 234-250.

Sheppard, Harold L, Louis A. Ferman and Seymour Faber
1960 Too Old to Work--Too Young to Retire: A Case Study of a Permanent Plant Shutdown. Washington, D.C.: Government Printing Office.

Wilcock, Richard C. and Walter H. Franke
1963 Unwanted Workers. Glencoe, Illinois: Free Press.

APPENDIX S.—MATERIAL SUBMITTED BY TOM MAURO, REPRESENTING THE NATIONAL SMALL BUSINESS ASSOCIATION: "THE JOB GENERATION PROCESS" BY DAVID BIRCH

THOMAS A. MAURO
ATTORNEY AND COUNSELLOR AT LAW
1604 K STREET, N.W.
WASHINGTON, D. C. 20006
—
(202) [illegible]
Suite 1113
1875 Connecticut Avenue, N.W.

April 9, 1980

The Hon. Berkley Bedell
Chairman
Subcommittee on Antitrust
House Committee on Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

Attention: Karen Berky

Dear Mr. Chairman:

In response to your letter of March 4, 1980, I am enclosing a corrected copy of my testimony on conglomerate mergers.

In addition, I enclose a copy of a study prepared by David Birch of M.I.T. entitled "The Job Generation Process" to which we made reference in our prepared testimony at page 2. If it is possible, I would appreciate your including Mr. Birch's study as part of the hearing record.

Thank you for allowing me to forward this material to you. As always, please do not hesitate to call me if you should have any questions.

Sincerely,

Thomas A. Mauro

TAM/cm
Enclosures

THE JOB GENERATION PROCESS

by

David L. Birch

M.I.T. Program on Neighborhood and
Regional Change

Cambridge, Mass.

1979

The research forming the basis for this report was conducted pursuant to Grant No. OER-608-G-78-7 from the Economic Development Administration of the U.S. Department of Commerce. The statements and conclusions contained herein are those of the contractor and do not necessarily reflect the views of the U.S. Government in general or the Economic Development Administration in particular.

THE JOB GENERATION PROCESS

SUMMARY

As our economy becomes more complicated, and as we strive to guide that economy in directions that will make it most productive for those who depend upon it for their livelihood, we must understand its inner workings better. In particular, we must understand how the activities of individual firms combine to create aggregate changes. For it is individual firms, not some abstraction called "the economy," that generate jobs, export products, utilize natural resources, and through their location decisions, determine settlement patterns in this country.

We have known very little about how the parts of the economy fit together to create a whole. Our focus has been either on the whole, and aggregate measures of it (like the GNP and its components), or on the individual firm as the unit of analysis, without reference to how firms combine to create the whole. Input/output analysis is one of the major exceptions to this generalization, striving as it does to relate transactions between businesses to the overall levels of activity in the economy. Welcome as this innovation has been, it suffers (through no fault of its own) from out-of-date data, and it does not trace its analysis back to the individual firm -- only to fairly large aggregations of firms trading with each other as blocs.

Our inability to understand the gap between micro and macro is now seriously hampering our efforts to develop economic policies that will generate jobs for the people and places that need them without causing inflation. We know very little about who generates jobs, where they generate them, who controls those jobs, and who is thus most likely to respond to economic development incentives. In the absence of such knowledge, our approach has usually been to stimulate whole economies with such shotgun-like policies as tax incentives and easy access to money and public works programs. This can be a very expensive and inflationary strategy if, in fact, most of the recipients do not use the incentives to increase employment and/or productivity. What we need, and have lacked, is the ability to target our incentives to those who can make good use of them without wasting taxpayers monies on those who cannot.

The project summarized in this brief paper represents an effort to bridge the gap from micro to macro, and having bridged the gap, to begin to understand the job generation process. We have approached this problem by creating a data file on each of 5.6 million business establishments. Collectively they encompass about 82 percent of all private sector employment. For each establishment, we know, for four different points in time (1969, 1972, 1974 and 1976) the establishment's size, age, 4-digit SIC code, corporate affiliation, location, and sales. By comparing these items over time for the same establishment, we are able to define and measure the processes by which change takes place (new formations, expansions, contractions, dissolutions, and movements) for each establishment. By aggregating establishments in any given place, we can, for the first time, describe in considerable detail how economic change occurs in that place. Thus, in a sense, we have developed an "economic microscope" that permits the policy maker to look beneath the surface, to see what is going on at the "atomic level," and presumably to develop more rifle-like policies that will be in harmony with the observed inner workings.

Our first steps, summarized in this initial report, were aimed simply at understanding the structure of the job generation process. We were interested in answering obvious initial questions. Who generates jobs, and who destroys them? Do the rates of gain and loss vary from place to place or over time? Who controls the process; is it mostly local or does it reach across areas and regions? How do the answers to these questions vary by industry? How can you separate those firms that will create jobs in the future from those who will not based on their past history? These are the questions we began asking, and these are the questions for which initial answers are presented in this report.

We have organized our endeavor into three broad categories: (1) components of change, (2) job generation and (3) interregional control. This brief summary will highlight the major findings and will present summary support for these findings when possible. Detailed analysis and tables are contained in the full report.

Components of Change

The first thing we did when we had merged all the establishment records together was simply to examine the relative magnitude of the six basic ways in which employment change can take place:

1. Births
2. Deaths
3. Expansions
4. Contractions
5. In-moves
6. Out-moves

We did this by state and for a set of 315 areas in the United States that are essentially the metropolitan and rural parts of BEA areas. We also did it for several time intervals to see if we could observe any variations caused by the business cycle (see Table 1). From these detailed tables we observe:

1. Virtually no firms migrate from one area to another in the sense of hiring a moving van and relocating their operations. The oft-cited move of textiles and shoes from New England to the South represented a rare fluke in the 1950's, not an example of a significant process today.

2. The rate of job loss due to the other two processes causing loss (deaths plus contractions) is about the same everywhere and is quite high -- 8% per year. Northern cities are not loosing jobs faster than southern ones, nor are cities losing jobs particularly faster than suburbs. It appears to be management skill rather than location that determines job loss. This shows up quite clearly in Table 1, where states are grouped according to their rate of growth. Most of the variation in net change is due to variation in the rate of job generation (births and expansions), not to variation in the rate of loss.

3. The components of change do seem sensitive to the business cycle over time. For most states, births and expansions were fewer and deaths and contractions were more numerous during the economic downturn in the mid 1970's then during the more prosperous period preceding the downturn.

The findings suggest that it makes little sense to attempt to influence firms to move (in the physical sense), nor is there much opportunity, short of influencing the business cycle, to influence the rate at which firms contract or go out of business. Practically all the leverage lies in affecting where new firms locate and where existing firms choose to expand. It thus becomes quite important to know what kinds of firms generate jobs.

Table 1

Annual Rate of Employment Change for States
by Growth Rate[1] of State

State Growth Rate			1969-72			
	Births	Deaths	Expan.	Contr.	In.	Out
Fast	7.5	5.6	6.2	2.7	.1	.03
Moderate	6.0	5.2	4.7	2.8	.2	.03
Slow	4.5	4.8	4.0	2.9	.03	.03
Decline	3.9	5.1	3.4	3.2	.2	.1
U.S. Ave.	5.6	5.2	4.7	2.9	.1	.03

			1972-74			
	Births	Deaths	Expan.	Contr.	In	Out
Fast	6.5	4.6	5.8	2.5	.1	.05
Moderate	5.0	4.4	5.0	2.7	.05	.05
Slow	4.3	4.6	4.5	2.9	.2	.1
Decline	-	-	-	-	-	-
U.S. Ave.	5.5	4.5	5.3	2.6	.1	.05

			1974-76			
	Births	Deaths	Expan.	Contr.	In	Out
Fast	9.5	5.7	5.4	3.1	.2	.05
Moderate	6.9	5.3	4.4	3.3	.1	.1
Slow	6.2	6.1	4.4	3.5	.1	.1
Decline	4.5	5.4	3.6	3.8	.2	.1
U.S. Ave.	6.7	5.7	4.4	3.4	.1	.1

---

[1] The four classes of employment change are: Fast (over 4 percent per year), Moderate (2 to 4 percent per year), Slow (0 to 2 percent per year) and decline (less than 0 percent per year). On the average, this breakdown divides states into four roughly equal groups, although the size of the groups in any particular year is sensitive to the business cycle.

Job Generation

We have approached job generation from several different points of view, but the main focus in each instance has been to identify those firms that historically have contributed the most to replacing the 8% per year losses caused by death and contraction, so that such firms can be singled out for policy purposes.

Table 2 shows the relative contribution of different types of firms (as defined by their status) to the generation of jobs either by forming new establishments or by expanding.

1. Roughly 50% of the replacement is due to births and 50% is due to expansions.
2. About 40% of the birth-generated jobs and 60% of the expansions are produced by independent, free-standing entrepreneurs. In combination, then, about half of the total jobs generated are generated by independents, half by multi-part corporations.
3. Branching is quite important, both in absolute magnitude and in its differential effect on where growth takes place. The south attracts many more branches than the north. Thus it is differential branching, not physical migration, that causes many of the regional differences in job growth. Also, branching seems to be growing in importance over time.
4. Branching is more important in manufacturing than in other sectors of the economy.

We are still left with the question: What kind of establishments and firms are generating jobs within these broad status categories? Is it large or small firms that are taking up the slack, and in what industries?

Before answering that question, we had to take a complicated and time-consuming step. The data we start with is recorded for each establishment -- each separate facility, be it a branch store or plant, a subsidiary, a headquarters or an independent. Yet it is firms, not establishments, that

Table 2

Status of Firms vs Employment Gains by Region, 1969-72, 1972-74, 1974-76

Births

Percent Employment Gains in firms that are:

	Time Period	Inde-pendent	Head Quarters	Subsi-diary	Branch/ HQ in State	Branch/ HQ out of State
Northeast	1969-72	39.0	6.1	5.2	20.3	29.5
	1972-74	35.6	4.1	3.9	21.4	34.9
	1974-76	23.6	2.0	1.4	31.9	41.1
North Central	1969-72	39.7	6.3	3.5	16.0	34.5
	1972-74	30.3	3.5	2.5	20.4	43.3
	1974-76	19.9	1.4	1.1	33.1	44.5
South	1969-72	37.1	5.5	4.6	12.8	39.9
	1972-74	36.2	3.9	3.0	13.9	43.1
	1974-76	25.2	1.6	1.4	21.1	50.6
West	1969-72	40.3	5.5	4.1	20.8	29.4
	1972-74	44.0	4.0	2.5	21.5	28.0
	1974-76	24.0	1.7	1.1	31.6	41.6

Expansions

Percent Employment Gains in firms that are:

	Time Period	Inde-pendent	Head Quarters	Subsi-diary	Branch/ HQ in State	Branch/ HQ out of State
Northeast	1969-72	63.1	16.5	4.2	4.4	11.7
	1972-74	56.2	20.2	5.8	5.7	12.0
	1974-76	58.2	21.1	6.7	4.2	9.8
North Central	1969-72	58.3	15.2	3.0	8.1	15.4
	1972-74	55.4	20.7	4.6	6.0	13.2
	1974-76	54.5	20.9	5.0	6.3	13.3
South	1969-72	59.2	13.3	4.8	4.2	18.5
	1972-74	56.0	15.9	5.0	3.7	19.3
	1974-76	54.2	17.4	5.7	4.6	18.1
West	1969-72	60.4	15.6	3.1	7.5	13.3
	1972-74	58.2	21.0	3.7	6.0	11.0
	1974-76	56.9	22.2	4.6	5.3	11.0

are making job expansion decisions. So, before we can identify the economic scale at which jobs are being generated, we must first bundle all the members of each corporate family into a single entity called the Firm, and then do our analyses for firms.

When we completed the bundling process, we began to ask questions about firm size. We know that the rate of loss is more or less constant for all kinds of firms within places. So we broke out each of the six components of change by size of *firm* and netted the losses against the gains to see which firms were net job generators. Table 3 presents the results for the United States as a whole. They are rather striking:

1. Small firms (those with 20 or fewer employees) generated 66% of all new jobs generated in the U.S.
2. Small, independent firms generated 52% of the total.
3. Middle sized and large firms, on balance, provided relatively few new jobs.
4. There was considerable regional variation in this pattern. Small business generated all net new jobs in the Northeast, an average percentage in the Midwest, and around 54 and 60 percent in the South and West respectively.

It appears that it is the smaller corporations, despite their higher failure rates, that are aggressively seeking out most new opportunities, while the larger ones are primarily redistributing their operations.

This very strong, basic finding raises questions about a life cycle phenomenon. Could it be that most firms start small, that some grow, and that once a corporation has stabilized at some level, it becomes mature and contributes very little to job generation? We began to search for such life cycle phenomena.

A first step was to return to individual establishments and determine which age categories accounted for most of the births and expansions. Table 4

Table 3

Percentage of Total Jobs[1] Generated by Size and Status for Regions and the U.S. between 1969 and 1976

Region	Ownership	0-20	21-50	51-100	101-500	500+	Total
	Indep.	129.1%	-11.2%	-22.3%	-21.1%	24.3%	98.8%
North East	HQ/Br	36.4	10.5	1.3	- 6.6	-32.8	8.8
	Par/Sub.	11.6	7.2	3.6	- 5.5	-24.4	- 7.6
	Totals	177.1	6.5	-17.4	-33.3	-32.9	100.0
	Indep.	52.8%	4.5%	.3%	- 2.8%	2.9	57.7
North Central	HQ/Br	12.4	5.8	3.8	4.9	13.1	39.9
	Par/Sub.	2.0	1.7	1.2	1.0	- 3.5	2.4
	Totals	67.2	12.0	5.2	3.1	12.4	100.0
	Indep.	42.7%	5.7%	1.5%	0.0%	.4%	50.1%
South	HQ/Br	9.3	4.0	2.9	7.4	16.7	40.3
	Par/Sub.	1.5	1.5	1.1	2.0	3.3	9.6
	Totals	53.5	11.2	5.5	9.4	20.4	100.0
	Indep.	47.8%	5.9%	2.2%	1.9%	2.9%	60.8%
West	HQ/Br	10.0	4.3	3.0	6.2	8.6	32.0
	Par/Sub.	1.7	1.4	1.1	1.8	1.8	7.2
	Totals	59.5	11.6	6.3	9.3	13.3	100.0
	Indep.	51.8%	4.4%	0.0%	- 1.5%	3.1%	57.8%
U.S.	HQ/Br	11.9	4.9	3.1	5.6	10.6	36.1
	Par/Sub.	2.3	1.9	1.3	1.1	- .5	6.1
	Totals	66.0	11.2	4.3	5.2	13.3	100.0

---

1. Total jobs generated in each region are: Northeast (410,890), North Central (1,674,282), South (2,873,619), and West (1,800,112).

Table 4

Percent Distribution of New Jobs Created in Each Region Between 1974 and 1976 by Age of Establishment

Industry	Region	0-4	5-8	9-12	13+	Total
Manufacturing	Northeast	67.3%	13.9%	9.3%	9.6%	100%
	North Central	75.4	9.9	8.6	6.1	100
	South	74.1	15.1	6.2	5.9	100
	West	71.0	13.1	8.9	7.0	100
Trade	Northeast	78.2%	9.4%	6.2%	6.1%	100%
	North Central	81.5	8.5	5.4	4.7	100
	South	82.2	8.4	5.1	4.5	100
	West	81.8	8.7	5.1	4.6	100
Service	Northeast	79.4%	8.5%	7.4%	4.7%	100%
	North Central	84.7	7.0	4.6	3.8	100
	South	84.8	7.3	4.3	3.6	100
	West	87.3	5.9	3.4	3.4	100
Total	Northeast	75.5	10.4	7.5	6.6	100%
	North Central	80.8	8.4	6.0	4.8	100
	South	80.4	9.9	5.1	4.6	100
	West	80.9	8.8	5.5	4.8	100

summarizes the results:

1. Young firms play a crucial role, generating about 80% of all replacement jobs.

2. This pattern holds across all sectors of the economy and across all regions.

Having discovered that age as well as size made a big difference, we began to analyze along both dimensions separately in most of our work. A first step was to return to the components of change and ask: For those establishments existing in 1969, what had happened to them by 1976, and how did it happen. The results, presented for the U.S. in Table 5, are consistent with our aggregate findings, and add some new dimensions as well.

1. The odds of an establishment dying over this 7-year period are quite high (as we already know from Tables 1 and 2 for a shorter interval).

2. The odds of dying vs contracting are quite sensitive to size -- with a sharp break around 20 employees. Those establishments below 20 are more likely to die than contract. Those above 20 lay off part of their workforce before going out of business.

3. Of those who survive, small firms are four times more likely to expand than contract, and larger firms are 50 percent more likely to shrink than to grow.

The odds of an establishment dying, growing, or declining give little feeling for the magnitude of the resulting employment changes. Table 6 gives us a feeling for the distribution of employment generation by age and size. Now we can see the relative magnitude of the changes as well as their direction. As can be seen:

1. The corporate population is quite volatile. Conditional on surviving, establishments are almost as likely to experience big changes as small ones -- particularly small establishments. While there is some clustering around the mean, it is not nearly so great as we had anticipated.

Table 5

Components of Change by Age and Size for Establishments in the U.S. 1969-1976

Size	Age	EXPAND	CONTRACT	DIE	TOTAL
0-20	0-4	27.6	7.6	64.8	503406
	5-9	32.7	10.4	56.9	372897
	10+	33.4	12.5	54.1	882762
	TOTALS	31.6	10.7	57.8	1759065
21-50	0-4	25.2	24.4	50.4	20867
	5-9	29.9	32.1	38.0	18950
	10+	31.8	39.0	29.2	63415
	TOTALS	30.1	34.8	35.1	103232
51-100	0-4	23.4	29.1	47.4	5486
	5-9	26.9	35.1	37.9	5111
	10+	28.7	43.6	27.7	20819
	TOTALS	27.5	39.7	32.8	31416
101-500	0-4	21.7	31.9	46.3	3369
	5-9	24.5	37.9	37.6	2595
	10+	28.7	45.6	25.7	13191
	TOTALS	26.9	42.2	30.9	19155
500+	0-4	23.9	39.6	36.6	331
	5-9	21.0	38.7	40.3	181
	10+	35.1	46.7	18.2	1631
	TOTALS	32.2	44.9	22.9	2143
TOTAL	0-4	27.4	8.6	63.9	533459
	5-9	32.4	12.0	55.6	399734
	10+	33.1	15.4	51.5	981818
	TOTALS	31.4	12.8	55.8	1915011

Table 6

Percentage Change for Establishments by Age and Size for the U.S. 1969-76

Percent Employment Change

Age	Size	Death	-50 to -99	-25 to -49	-1 to -24	0 to 24	25 to 49	50 to 99	100+
0-4	0-20	62.7	2.8	2.9	1.6	10.1	2.9	4.4	12.5
	21-50	46.4	8.9	6.3	7.3	14.7	5.2	5.1	6.2
	51-100	44.3	10.7	7.2	9.3	13.8	6.0	4.1	4.6
	101-500	43.6	10.6	9.2	10.2	13.5	5.0	4.7	3.2
	501+	33.3	11.8	12.4	11.8	18.5	6.1	4.4	1.7
	TOTALS	61.7	3.2	3.1	2.0	10.4	3.0	4.4	12.1

Age	Size	Death	-50 to -99	-25 to -49	-1 to -24	0 to 24	25 to 49	50 to 99	100+
5-9	0-20	53.7	3.8	3.8	2.3	13.8	3.8	5.5	13.4
	21-50	34.4	11.1	8.2	9.6	18.3	6.0	6.1	6.2
	51-100	34.7	12.5	9.4	10.3	16.6	6.1	5.5	4.9
	101-500	34.8	13.0	9.3	12.8	16.2	6.0	4.6	3.4
	501+	37.2	14.3	10.7	10.7	14.8	8.2	1.0	3.1
	TOTALS	52.4	4.3	4.1	2.8	14.1	3.9	5.5	12.9

Age	Size	Death	-50 to -99	-25 to -49	-1 to -24	0 to 24	25 to 49	50 to 99	100+
10+	0-20	50.2	4.2	4.4	3.0	16.2	4.3	5.7	12.0
	21-50	25.5	11.1	10.2	12.7	23.1	6.9	5.7	4.7
	51-100	24.7	13.2	11.5	14.1	21.0	6.4	5.2	3.8
	101-500	23.1	13.9	11.9	15.2	21.5	6.3	5.0	3.1
	501+	15.9	13.3	10.8	16.6	27.2	7.1	5.7	3.5
	TOTALS	47.5	5.1	5.1	4.1	16.8	4.5	5.7	11.2

Age	Size	Death	-50 to -99	-25 to -49	-1 to -24	0 to 24	25 to 49	50 to 99	100+
Total	0-20	54.4	3.8	3.8	2.4	14.0	3.8	5.3	12.5
	21-50	31.2	10.7	9.0	11.1	20.6	6.4	5.6	5.3
	51-100	29.6	12.7	10.5	12.7	19.1	6.3	5.1	4.1
	101-500	28.1	13.2	11.1	14.0	19.4	6.1	4.9	3.2
	501+	20.2	13.1	11.1	15.4	24.9	7.0	5.1	3.2
	TOTALS	52.4	4.4	4.3	3.2	14.5	4.0	5.3	11.8

2. This phenomenon is not very sensitive to age. Maturity does not guarantee stability in the harsh corporate world. Each year is a new year, and the fact that an establishment has survived for 10 years seems to have little effect on what will happen to it in the 11th year other than increasing its odds of being there.

The fact that age has little effect on next year's expectations does not mean that the recent experience of the establishment should have no effect. If we wish to identify firms that promise to generate jobs in the future, one potentially interesting clue is likely to be the experience of the firm's establishments in the recent past. With three different time intervals in the files, it is possible to trace the history of each individual establishment. The first two intervals (1969-72 and 1972-74) were treated as history, and we assessed what effect this five-year history had on the ability of the establishment to survive and/or thrive in the rather difficult period 1974-76. In particular, we defined seven possible historical trajectories through 1974:

Trajectory	Types and Number of Changes	Magnitude of Change 69-74
1	2 Expansions	Big +
2	2 Expansions	Small +
3	1 Expan/1 Contract.	Big +
4	1 Expan/1 Contract.	Small Change
5	1 Expan/1 Contract.	Big -
6	2 Contractions	Small -
7	2 Contractions	Big -

where a big change is greater than 50% and a small change is less than 50% over this five year interval. Table 7 reveals the behavior of each establishment that survived the 1969-74 period during 1974-76. Some of the results

Table 7

Influence of Previous History on Immediate Future of Establishments in the U.S. 1969-1976

Change: 1974-76

Size	Number and Type of Changes 1969-74	Mag. of Change 1969-74	BIG+	NEUTRAL	BIG-	DEATH	TOTAL
	2 Expansions	Big +	11.2	68.1	16.4	4.3	82396
	2 Expansions	Small +	10.2	77.7	9.3	2.8	6902
0-20	1 Expan/1 Contract.	Big +	9.4	63.8	10.5	16.3	321777
	1 Expan/1 Contract.	Small Chg.	9.6	56.9	6.8	26.7	731939
	1 Expan/1 Contract.	Big -	17.8	55.8	3.3	23.1	38349
	2 Contractions	Small -	13.5	68.3	10.3	7.9	9820
	2 Contractions	Big -	23.1	58.8	5.9	12.2	8355
		TOTAL	10.0	59.7	8.4	21.8	1199538

Size	Number and Type of Changes 1969-74	Mag. of Change 1969-74	BIG+	NEUTRAL	BIG-	DEATH	TOTAL
	2 Expansions	Big +	10.6	68.6	16.7	4.1	5722
	2 Expansions	Small +	7.6	80.1	9.5	2.8	3073
21-50	1 Expan/1 Contract.	Big +	9.3	64.6	18.8	7.3	8664
	1 Expan/1 Contract.	Small Chg.	8.4	68.3	11.7	11.7	72515
	1 Expan/1 Contract.	Big -	18.3	56.2	8.7	16.8	8350
	2 Contractions	Small -	8.6	70.6	13.4	7.4	3187
	2 Contractions	Big -	20.0	57.2	9.8	13.0	2933
		TOTAL	9.7	67.1	12.2	11.0	104444

Size	Number and Type of Changes 1969-74	Mag. of Change 1969-74	BIG+	NEUTRAL	BIG-	DEATH	TOTAL
	2 Expansions	Big +	9.3	68.6	18.0	4.0	1691
	2 Expansions	Small +	7.3	81.4	9.2	2.1	1186
51-100	1 Expan/1 Contract.	Big +	8.1	63.5	20.0	8.5	2376
	1 Expan/1 Contract.	Small Chg.	7.9	67.8	12.7	11.5	23651
	1 Expan/1 Contract.	Big -	18.1	56.4	10.0	15.5	3095
	2 Contractions	Small -	7.8	72.0	13.0	7.2	1407
	2 Contractions	Big -	19.1	54.3	12.1	14.5	1123
		TOTAL	9.2	66.7	13.1	10.0	34529

Table 7 (con't)

			Change: 1974-76				
Size	**Number and Type of Changes 1969-74**	**Mag. of Change 1969-74**	**BIG+**	**NEUTRAL**	**BIG-**	**DEATH**	**TOTAL**
	2 Expansions	Big +	8.6	70.4	16.9	4.1	1029
	2 Expansions	Small +	6.0	79.1	11.4	3.4	1059
101-500	1 Expan/1 Contract.	Big +	6.6	68.6	17.1	7.6	1491
	1 Expan/1 Contract.	Small Chg.	6.9	68.3	12.2	12.6	19046
	1 Expan/1 Contract.	Big -	16.4	58.6	9.8	15.2	2097
	2 Contractions	Small -	6.9	72.0	15.3	5.9	1173
	2 Contractions	Big -	21.1	51.8	14.5	12.6	902
		TOTAL	8.2	67.7	12.6	11.6	26797

Size	**Number and Type of Changes 1969-74**	**Mag. of Change 1969-74**	**BIG+**	**NEUTRAL**	**BIG-**	**DEATH**	**TOTAL**
	2 Expansions	Big +	5.7	74.5	18.9	0.9	106
	2 Expansions	Small +	6.0	79.1	10.9	4.0	201
501+	1 Expan/1 Contract.	Big +	6.5	74.0	14.0	5.5	200
	1 Expan/1 Contract.	Small Chg.	6.1	72.5	11.0	10.4	3708
	1 Expan/1 Contract.	Big -	12.8	65.6	12.4	9.2	282
	2 Contractions	Small -	3.7	74.4	15.3	6.6	242
	2 Contractions	Big -	14.4	60.6	14.4	10.6	160
		TOTAL	6.6	72.2	11.7	9.5	4899

Size	**Number and Type of Changes 1969-74**	**Mag. of Change 1969-74**	**BIG+**	**NEUTRAL**	**BIG-**	**DEATH**	**TOTAL**
	2 Expansions	Big +	11.1	68.1	16.5	4.3	90944
	2 Expansions	Small +	8.9	78.8	9.5	2.8	12421
Total	1 Expan/1 Contract.	Big +	9.4	63.8	10.8	16.0	334508
	1 Expan/1 Contract.	Small Chg.	9.4	58.5	7.6	24.6	850859
	1 Expan/1 Contract.	Big -	17.8	56.1	4.9	21.2	52173
	2 Contractions	Small -	11.4	69.4	11.6	7.8	15829
	2 Contractions	Big -	21.9	57.6	8.0	12.6	13473
		TOTAL	9.9	60.6	8.9	20.5	1370207

are what we expected, some are very surprising (but consistent):

1. Two periods of expansion substantially lower the odds of death in the third period, and tend to raise the odds of a substantial gain in the third period.

2. On the other hand, a big gain in the past tends also to lead to a higher than average expectation of a big loss. Volatility cuts both ways; what has gone up has a higher than average tendency to go down in the next period.

3. The biggest gainers of all, curiously but very consistently, are establishments that declined the most during the recent past, but survived. These establishments have a higher than average expectation of dying, but, if they make it, they are the ones most likely to generate a large number of new jobs in the future. On balance, they are in fact two or three times more likely to be large job generators.

4. Firms that didn't do much of anything in the past (one up, one down, not much change) -- the so-called stable firms -- are among the most likely to die and the least likely to expand. There is not much to be said for stability.

5. There is little variation in these tendencies across regions and industries.

A pattern begins to emerge in all of this. The job generating firm tends to be small. It tends to be dynamic (or unstable, depending on your viewpoint) -- the kind of firm that banks feel very uncomfortable about. It tends to be young. In short, the firms that can and do generate the most jobs are the ones that are the most difficult to reach through conventional policy initiatives.

Interregional Control

There is a nagging question that persists throughout the debate over growth in different parts of the country: To what extent is apparent growth in one part of the country (like the South) really being controlled by firms headquartered elsewhere (like in the North)? As corporate families were bundled together, we were careful to keep track of the location of the parent or headquarters of each branch or subsidiary. We are thus now able to address this question. As we observed earlier, branching is the main form of corporate expansion. Table 8 shows the extent of the interregional control of branches. As can be seen:

1. There is a great deal of interregional control. While the majority of jobs generated in branches and subsidiaries in a region tend to be under the control of headquarters and parents in the same region, this is not always the case, and in many instances, the majority is a bare majority.

2. In manufacturing, the great majority of jobs generated in the South are controlled in the Northeast and North Central parts of the country.

3. Relatively few corporations anywhere are opening or expanding facilities in the Northeast. The North Central section is slightly better off.

4. Even in the trade sector, almost two thirds of the Southern growth is controlled by northern corporations.

5. Only in the service industries does each region tend to dominate its own territory, with the interesting anomaly that, in this newest and most rapidly expanding sector of the economy, southern corporations are dominating northern and western establishments. In branches, for example, southern headquarters generated almost as many service jobs in the Northeast as northern firms did, substantially more jobs in the midwest than midwesterners did, and substantially more jobs in the West than westerners did.

We thus see a strange mix of old and the new. While northerners continue to dominate the declining manufacturing sector as it relocates (through differential investment) in the south, entrepreneurial southerners are latching on to the growing service sector and are aggressively dominating the generation of jobs in this sector throughout the country. In the process, they are effectively precluding entry by northerners in the South by dominating the growing southern market.

Table 8

Percent Distribution of Net Employment Change due to Differential Treatment of Branches by Headquarters

Industry	Location of Headquarters	Controlling Branches in: N. East.	N. Central	South	West
Manu-facturing	N. East	53%	30%	31%	29%
	N. Central	34	59	41	39
	South	7	4	16	12
	West	6	7	13	21
		100%	100%	100%	100%
Other	N. East	65%	23%	23%	19%
	N. Central	21	57	18	23
	South	7	11	43	4
	West	7	9	16	53
		100%	100%	100%	100%
Trade	N. East	65%	18%	21%	16%
	N. Central	25	68	35	32
	South	5	8	37	7
	West	5	6	7	45
		100%	100%	100%	100%
Service	N. East	48%	14%	13%	14%
	N. Central	8	33	7	7
	South	40	50	75	47
	West	4	3	5	32
		100%	100%	100%	100%

On a more general level, there is a tremendous amount of interregional influence and control. Corporations do not hesitate at all to open and expand operations elsewhere in the country as it suits their needs. We cannot at all assume that each region holds its destiny in its own hands. In fact, a much safer assumption is that half (or more) of the jobs generated by multi-establishment corporations in a region are controlled outside of that region.

In Conclusion

It is no wonder that efforts to stem the tide of job decline have been so frustrating -- and largely unsuccessful. The firms that such efforts must reach are the most difficult to identify and the most difficult to work with. They are small. They tend to be independent. They are volatile. The very spirit that gives them their vitality and job generating powers is the same spirit that makes them unpromising partners for the development administrator.

The easier strategy of working with larger, "known" corporations whose behavior is better understood will not be, and has not been, very productive. Few of the net new jobs generated in our economy are generated by this group. Furthermore, the larger corporations, using their financial strength, are the first to redistribute their operations out of declining areas into growing ones. They do not hesitate to locate branches in greener pastures, placing an even greater burden on the smaller firms in struggling areas like the Northeast.

There is no clear way out of this quandary -- there are only general guidelines -- and most of them are of a negative, "do not" nature. Do not, for example expend resources attempting to stem physical migration -- in the textile industry sense -- because it is relatively insignificant and counterbalancing. Do not count on, or address major resources toward, larger corporations, whose powers of net generation are small and whose tendencies to shift location quickly are well demonstrated. Do not try to influence the rate of job loss, since it is practically the same in all states, and worry instead about how to encourage job replacement.

Advice on how to encourage job replacement is more difficult to give. We know that smaller, volatile firms are the major replacers of lost jobs, but we have no experience in identifying and assisting them in large numbers. Because they are small, we must reach many of them to have a measurable effect. Because they are volatile, we must monitor each individual firm's performance carefully if we are to gain maximum benefit from our invested dollars (on the high side) and avoid scandal (on the low side).

From this research's viewpoint it seems like a very difficult problem to solve administratively. A massive bureaucracy would be required to monitor individual small businesses on the scale required to change the direction of an area's economy. New England alone houses about 193,000 businesses with 20 or fewer employees, not to mention those in the 20 to 500 range (another 27,000). And New England represents a relatively small percent of the national total. It seems almost certain that our approach must be indirect, not direct, relying on existing networks of institutions rather than building large new ones.

It is not clear what to offer job-replacing firms. Some have argued persuasively that small businesses need, use well, and cannot easily get, capital. Beyond that, however, the answers are less clear. Most studies of location find that local corporate tax differences are a relatively unimportant reason for choosing a location. Our own work on factor costs[1] suggests that, in many important instances, factor costs differences are small and/or are disappearing and that, even when they are large, they do not have a dominant effect. The most rapidly growing places in the United States in the 1970's tend to have higher than average factor costs.

Our own survey work, and that of others,[2] suggests that, for many businesses, the quality of life experienced by the managers of companies is very important. They want to avoid personal (as distinct from corporate) income taxes, crime, congestion, and the hassle of government regulation and want to find places which they find physically attractive with good schools and housing and recreational activities. We plan to delve much more deeply into this phenomenon in the months ahead. Suffice it to say here that strategies of economic development may have to address the quality of the physical environment of a place and the attitudes of its local government at least as much as the immediate economic problems and needs of its corporate inhabitants if they are to be successful.

The puzzle is a complicated one. We cannot afford to spend large sums on incentives that generate a relatively small number of jobs. But nor can we afford to ignore the effect that corporate decisions are having on millions of individuals and households. We must learn to shoot with a rifle rather than a shotgun if we are to be effective and noninflationary. Rifle-shooting requires a kind of knowledge that we simply have not had, and must obtain if we are going to do it at all well.

---

[1] See Birch, Regional Differences in Factor Costs: Labor, Land, Capital and Transportation. MIT Program on Neighborhood and Regional Change, 1978.

[2] See a recent analysis of 3,000 central city businesses by Matz entitled Central City Businesses -- Plans and Problems (Joint Economic Committee, 1979).

APPENDIX T.—MATERIAL SUBMITTED BY HON. JAMES HANLEY; RE GENERAL MOTORS AND ANTICOMPETITIVE PRACTICES

JAMES M. HANLEY
[illegible]

[illegible]

COMMITTEES:
CHAIRMAN
POST OFFICE AND CIVIL SERVICE
CHAIRMAN, SUBCOMMITTEE ON INVESTIGATIONS
BANKING, FINANCE AND URBAN AFFAIRS
SUBCOMMITTEES:
HOUSING AND COMMUNITY DEVELOPMENT
FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE
THE CITY
SMALL BUSINESS
SUBCOMMITTEE:
ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS

Congress of the United States
House of Representatives
Washington, D.C. 20515

February 15, 1980

The Honorable Berkley Bedell
Chairman, Subcommittee on Antitrust
and Restraint of Trade Activities
Affecting Small Business
House of Representatives
Room B363 Rayburn House Office Building
Washington, D. C. 20515

Dear Mr. Chairman:

The purpose of this letter is to suggest that you include the attached material in the Antitrust Subcommittee's hearing record on Conglomerate Mergers and Their Effects on Small Business and Local Communities.

During the Subcommittee's February 12, 1980, hearing, I engaged in a dialogue with Professor Yale Brozen of the University of Chicago about General Motors' attempts to monopolize the transportation industry by purchasing and replacing, with the help of partners, highly efficient urban electric-transit systems with bus operations that they, and their partners, had great interest in.

The attached material is from a book authored by Morton Mintz and Jerry Cohen, Power, Inc. Pages 229-231, with appropriate references, outline the case that I presented to Mr. Brozen: that General Motors and their partners engaged in practices that clearly ran counter to the public interest in an attempt to monopolize and restrict entry into the mass transportation industry.

Thank you for your courtesy and cooperation in this regard.

With best wishes, I remain

Sincerely yours,

Jim

James M. Hanley
Member of Congress

Enclosure
JMH:Kgm

Power, Inc.

Public and Private Rulers and How to Make Them Accountable

Morton Mintz & Jerry S. Cohen

The Viking Press
NEW YORK

Eroding Competition

24

Conflicts of interest in commerce erode competition, which is society's primary instrument for making trade accountable. Consider ground transportation. One passenger train can carry as many persons as one thousand automobiles, one subway car as many as fifty autos, and one bus as many as thirty-five. Yet, the government allowed General Motors to dominate production of diesel locomotives and diesel buses as well as of automobiles. Thus, GM has had a truly staggering conflict of interest which it has resolved in the most obviously profitable manner: by doing everything within its power to push the sale of automobiles—until recently, it may be added, big, fat automobiles enormously wasteful of fuel and resources.

General Motors in 1949 was convicted of having conspired, mainly with Standard Oil of California and Firestone Tire and Rubber Company, to replace highly efficient urban electric-transit systems with bus operations which would contract never to buy new equipment "using any fuel or means of propulsion other than" petroleum. The conviction was upheld on appeal. The penalty inflicted on GM for this massive criminality was a fine of $5,000. GM's treasurer, also convicted, was fined a dollar.[1] Not surprisingly, GM continued through September 1955 to acquire electric rail and bus properties and to dieselize them. While railroads throughout the world electrified when they abandoned steam, ours switched to much less efficient diesel locomotives—because GM, the biggest single shipper, forced them to.[2]

The issue lay generally dormant until early 1974, when Philip A. Hart, the senior senator from Michigan, had the rare courage to hold hearings on the need to restructure the auto industry—which GM dominates, and which happens to be the keystone of his state's economy. On the opening day of the hearings, Bradford C. Snell, then an assistant counsel of the Senate Antitrust and Monopoly Subcommittee, which Hart heads, testified that GM played a dominant role in destroying more than one hundred electric surface rail-transit systems in fifty-six cities, including Baltimore, Philadelphia, New York, St. Louis, and Los Angeles, between 1932 and 1956. Based on an extensive study, *American Ground Transport*, which was financed by the Stern Fund of New York, Snell said the principal instrument of destruction was National City Lines (NCL), a holding company which GM and two suppliers of products used by buses, Socal and Firestone, formed in 1936. In 1950, NCL's owners gave it $9 million with which to finance the convertion of transit systems in sixteen states to GM buses. By the mid-1950s, motorization of electric transit systems was virtually complete.

In the study, Snell provided a case history of Pacific Electric System, which served Southern California with the world's largest electric railway system. A $100 million enterprise, it operated three thousand trains through fifty-six incorporated cities and annually carried 80 million passengers. In 1938, GM and Socal formed an affiliate of NCL that began to buy and scrap electric rail systems in Fresno, San Jose, and Stockton. In 1940, the affiliate began to acquire and scrap portions of Pacific Electric. Finally, it motorized the heart of downtown Los Angeles. Snell, in a portion of the study which was later supported in a statement to the subcommittee by Tom Bradley, mayor of Los Angeles, said:

> Motorization drastically altered the way of life in Southern California. Today, Los Angeles is an ecological wasteland: The palm trees are dying from petrochemical smog; the orange groves have been paved over by 300 miles of freeways; the air is a septic tank into which 4 million cars, half of them built by General Motors, pump 13,000 tons of pollutants daily. . . . The substitution of GM diesel buses, which were forced to compete with automobiles for space on congested freeways, apparently benefited GM, Standard Oil, and Firestone, considerably more than the riding public. . . . As early as 1963, the city already was seeking ways of raising $500 million to rebuild a rail system "to supersede its present inadequate network of bus lines." . . . A decade later, the estimated cost of constructing a 116-mile rail system, less than one-sixth the size of the earlier Pacific Electric [which had extensive private rights-of-way], had escalated to more than $6.6 billion.[9]

In his testimony, Snell concluded that the Big Three—GM, Ford Motor Company, and Chrysler Corporation—"used their vast economic power to restructure America into a land of big cars and diesel trucks," making it into "a second-rate nation in ground transportation." He continued:

> Unlike every other industrialized country in the world, we rely on cars and trucks for virtually all of our transport needs.
>
> At the same time, in every city and suburb, our rail and bus services are either dead or dying. American travelers returning from Europe, for example, say there is a "bus gap." Even in Moscow, they say, the buses and subways look better than anything made in the United States. Travelers back from Japan tell the same story. Having ridden on 150 mile-per-hour bullet trains, they ask, "What ever happened to America's railroads?"
>
> Let me suggest an explanation: The Big Three companies eliminated competition among themselves, secured control over rival bus and rail industries, and then maximized profits by substituting cars and trucks for every other competing method of transportation, including trains, streetcars, subways, and buses. . . .
>
> Now we are running out of gas. And there are no public alternatives. No high-

speed trains. No rapid rail transit. No decent, fume-free buses [in Germany and other countries, buses that burn diesel fuel in outlying areas operate entirely on self-generated electricity in built-up areas]. Nothing but 100 million gas-guzzling cars.[4]

In a sixty-seven-page reply to these and other charges by Snell, GM said that it "did not generate the winds of change which doomed the streetcar systems," but did, "through its buses, help to alleviate the disruption left in their wake." Referring to the 1930s, GM said, "Times were hard and public transportation systems were collapsing. . . . GM was able to help with technology, with enterprise, and in some cases, with capital. . . . The buses it sold helped give mass transportation a new lease on life which lasted into the postwar years." With similar vehemence, the company denied that it had coerced railroads into buying its diesel locomotives, saying in part that the Justice Department had twice investigated the charge and concluded it "had no case."

That last point had an especially hollow ring. When Ramsey Clark was attorney general in the Johnson Administration, he made a special point of trying to keep abreast of Antitrust Division activities. Yet, he didn't know until 1966, when he read it in a newspaper, that the division had developed plans to try to split GM into six companies and Ford into two, and to end the franchised-dealer system for them and for Chrysler as well. The plans had been drawn up at the direction of Donald F. Turner, a Harvard law professor and economist, soon after he took charge of the division in 1965. But Turner not only never made a recommendation to Clark, but, said Thomas R. Asher, a former division attorney who testified before Hart, "totally refused to address himself" to the issue. Eight weeks after resigning in 1968, Turner, in a confidential, twelve-page memo that the senator obtained for the hearing record, urged his successor to file an antimonopoly suit against the Big Three, including "an individual monopolization count against GM." The Turner memo, Asher said, "was quietly buried after one relatively brief meeting" of high division officials.[5]

Chapter 24. Eroding Competition

[1] U.S. Congress, Senate, hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, *The Industrial Reorganization Act*, Ground Transportation Industries, 93d Cong., 2d Sess., 26, 27, 28 February; and 1 March 1974, pt. 3:1776–1777.

[2] Ibid., pp. 1839–1926; pt. 4A—appendix to pt. 4; and Morton Mintz, "GM Said to Ruin City Rail Systems," *Washington Post*, 25 February 1974. GM on April 10 submitted "The Truth about 'American Ground Transport'—a Reply by General Motors," and, at its request the Subcommittee printed it in full as a hearing volume.

[3] Op. cit. (above, n. 1), pt. 4A:A–31, A–32.

[4] Ibid., pp. 1840–1841.

[5] Ibid., pp. 1985–2045; and Morton Mintz, "U.S. Auto Antitrust Inaction Disclosed," *Washington Post*, 1 March 1974.

APPENDIX U.—MATERIAL SUBMITTED BY ROBERT HALL, EDA: EDA CONSIDERATION OF LOAN GUARANTEE ASSISTANCE TO YOUNGSTOWN, OHIO

INSERTION FOR THE RECORD

Hearings before the

COMMITTEE ON SMALL BUSINESS
Subcommittee on Antitrust and Restraint of Trade Activities
Affecting Small Business

U. S. HOUSE OF REPRESENTATIVES

Conglomerate Mergers
and their Effect upon
Local Communities and Small Businesses

February 27, 1980

best copy available

February 5, 1980

Consideration by the Economic Development Administration
of Application for Loan Guarantee Assistance
Submitted by the City of Youngstown, Ohio,
and the Ecumenical Coalition
of the Mahoning Valley
in February, 1979

Recently, charges have been raised by representatives of the Ecumenical Coalition of the Mahoning Valley concerning an application the Coalition submitted jointly with the City of Youngstown in February, 1979, seeking loan guarantee assistance from the Economic Development Administration (EDA) to reopen the Campbell Works which had been closed by the Lykes Corporation.

Two major issues have been raised. The first charges that the applicants were led to believe that the Administration was prepared to provide as much as $300 million in loan guarantees for a steel producing project in the Mahoning Valley, and that subsequently the Administration arbitrarily reduced the limit to $100 million.

In fact, the $100 million limitation was clearly expressed by the Administration time and time again. Mr. Jack Watson, Chairman of President Carter's Interagency Coordinating Council, convened a meeting on September 27, 1978 for representatives of the Ecumenical Coalition and the City of Youngstown to discuss with officials of various Federal agencies their preliminary plans to achieve economic adjustment in this troubled area. During that meeting, Mr. Watson made a commitment that the Administration, specifically EDA, would reserve $100 million in loan guarantee authority for a viable steel making project in the Mahoning Valley. In part because that commitment was misinterpreted in various newspaper accounts following that meeting, Mr. Watson reiterated the $100 million commitment in his letter of October 18, 1978, to the Rev. James Malone, Chairman of the Ecumenical Coalition, and Mayor Philip Richley of Youngstown. A copy of Mr. Watson's October 18 letter is attached. Furthermore, in numerous subsequent conversations between EDA and Youngstown officials the $100 million limitation on the commitment was repeated. The suggestion that as much as $300 million could be provided was specifically denied by EDA officials.

The second major issue that has been raised concerns the charge that EDA did not consult with the Coalition, nor did they give the Coalition a full and candid explanation of why the proposal was denied. In fact, the opposite is true. Between the time of the September 27 meeting with Mr. Watson and March 29, 1979, when Robert T. Hall, Assistant Secretary of Commerce for Economic Development, wrote to Bishop Malone indicating EDA's decision not to approve their project application, EDA consulted on many occasions with Coalition representatives, formally and informally, in meetings and by telephone. No request for consultation was ever denied.

On March 21, after the applicants' last proposal had been submitted to EDA, a meeting was held in Mr. Hall's office with representatives of the Ecumenical Coalition and the City of Youngstown to detail every one of EDA's concerns. In Mr. Hall's letter of March 29 to Bishop Malone, he indicated his willingness and that of Mr. Watson to meet with the applicants to discuss their application further if they so wished, and, in fact, such a meeting was held in Washington on April 3, 1979. Further meetings would have been held had the applicant requested them.

With regard to the question of whether the Administration fully informed the applicant as to why EDA denied the application, a review of the attached copy of Mr. Hall's March 29 letter will reveal that a clear and detailed rationale was provided at that time. That rationale was further discussed with the applicants at the April 3 meeting with Mr. Watson, and in fact Mr. Watson once again reiterated those reasons in his letter of May 9, 1979 to the applicant, a copy of which is attached.

It is clear from the record that the applicants were afforded every opportunity to consult with Administration officials both before and after the agency's decision, and they were fully informed of EDA's rationale. There is absolutely no justification whatsoever for the charge made by Coalition representatives that local officials were able to determine that rationale only by pursuing an action under the Freedom of Information Act.

As Mr. Watson's May 9 letter indicates, the Administration's decision to reserve $100 million in loan guarantee authority for a viable project in the Mahoning Valley still holds, and indeed EDA is continuing to work with Youngstown officials to develop such a project. However, it should be noted that this is not the only assistance which EDA has made available in anticipation of or in response to the serious economic dislocation problems in the Mahoning Valley.

The following list indicates the nature and level of adjustment-related support which EDA has provided since 1975:

- A $100,000 grant to the Western Reserve Economic Development Agency (WREDA) in June, 1975, to develop an economic adjustment strategy in response to threatened job losses in basic steel and related support sectors.
- A $260,000 grant to WREDA in July, 1975 for river bank restoration.
- A $1,195,000 grant to Youngstown in January, 1976 for industrial land development.
- A $1,627,870 grant to WREDA in September, 1976 to implement their economic adjustment strategy.

- A $301,600 grant to Trumball County in June, 1977 for an access road.
- A $631,000 grant to Campbell in September, 1977 for storm sewers.
- A $100,000 grant to the Mahoning County Commissioners in February, 1978 to develop a strategy taking into account the recent shutdown of Youngstown Sheet and Tube facilities.
- A $4,764,200 grant to Mahoning County in March, 1978 for a sewer system in Jackson Township.
- A $600,000 grant to the Mahoning Valley Economic Development Corporation in September, 1978 to develop a Comprehensive Economic Development Strategy for the metropolitan area, to assist CASTLO Community Improvement Corporation and to establish a staff capability to recruit new and expanded industry.
- A $1,350,000 business loan guarantee to reactivate the Republic Hose Manufacturing Corporation, formerly a subsidiary of Aeroquip Rubber.

The above listing includes $9,579,670 in grants and $1,350,000 in loan guarantees. It does not include another $833,370 in other grants not as directly related to economic adjustment made by EDA under its regular economic development program. It also does not include $5,404,272 in grant funds made available in FY 77 by EDA under Round I of the anti-recessionary Local Public Works Program nor $13,446,517 in grants awarded also in FY 77 under Round II of the Local Public Works Program. In addition, in May, 1979 EDA made a commitment to provide up to $30 million in loan guarantee assistance to Commuter Aircraft Corporation to construct a facility in Youngstown for manufacturing planes thereby creating an estimated 1,500 jobs.

As this record indicates, the commitment on the part of EDA and the Carter Administration to assist in the economic recovery of the Mahoning Valley has been and remains strong. Although it was necessary on the basis of clear programmatic concerns to deny approval of the application submitted in February, 1979 by the Ecumenical Coalition and the City of Youngstown, EDA is continuing to reserve $100 million under its steel loan guarantee program for a viable project in the Mahoning Valley. In addition, Assistant Secretary Hall recently stated publicly that assuming enactment of EDA's reauthorization legislation (S. 914) which is currently in House-Senate Conference and which would authorize a significantly expanded business finance program, EDA would hold $125 million in loan and loan guarantee assistance for use in the Mahoning Valley to strengthen and diversify the economy of this area.

Attachments

October 18, 1978

The Most Reverend James W. Malone
Chairman
Ecumenical Coalition of the Mahoning Valley

The Honorable J. Phillip Richley
Mayor of the City of Youngstown

The Honorable John Glenn
United States Senate

The Honorable Howard W. Metzenbaum
United States Senate

The Honorable Charles J. Carney
U. S. House of Representatives

Gentlemen:

The following is a progress report on the Interagency Coordinating Council's review of the economic development proposals for the Mahoning Valley we discussed on September 27, 1978. The economic problems of the Mahoning Valley and various proposed solutions are on the agenda of the Interagency Coordinating Council, which I chair. At my request, Assistant Secretary of Commerce Robert T. Hall has been heading a working group of representatives of Federal agencies on the Council which have information and/or resources relevant to the situation in the Valley.

During the last three weeks, we have consulted widely with knowledgeable individuals about the steel industry, including representatives from both management and labor and the public at large. Everyone concerned appreciates the leadership which has been taken by the Congressional delegation, local public officials, the Mahoning Valley Economic Development Council and the Ecumenical Coalition in helping to develop proposals to deal with the problem.

During the course of our work, we were all pleased by the announcement of the agreement reached by the Environmental Protection Administration and Republic Steel Company which assures that the Mahoning Valley will continue to remain one of the world's great steel-producing centers for years to come. As a result of that agreement, which was announced at the White House October 6, 1978, the company will invest approximately $225,000,000 in modern, pollution-free facilities and will assure retention of more than 6,000 jobs in the Youngstown area.

Although the agreement does not restore the jobs lost in the closing of the Youngstown Sheet and Tube facilities, it should help allay the fears of many residents in the Mahoning Valley regarding the Valley's future economic well-being.

Four proposals were discussed at our meeting. They were:

(1) The proposal by the Ecumenical Coalition that it be given a federal grant of $15,000,000 to proceed with further studies and acquisition of properties in connection with the establishment of a community-based organization to reopen the closed facilities of the Youngstown Sheet and Tube Corporation. The Federal government was also asked to reserve $300,000,000 in loan guarantee authority to assist the new organization in modernizing the closed facilities and putting them into operation. In addition, the Federal government was asked to direct federal procurement to the new company.

(2) The proposal by the Mahoning Valley Economic Development Council for the establishment of a national steel research and development center in the Mahoning Valley.

(3) A proposal for the establishment of a unit train for the movement of ore from Lake Erie to the Mahoning Valley in order to reduce freight costs.

(4) A proposal for the establishment of a joint blast furnace.

Community-Based Corporation

With regard to the proposal for the establishment of a community-based corporation to reopen and operate the closed Sheet and Tube facilities, I must report that it is not possible for us to reach a decision at this time. The information on which such a decision must be based is not fully available to us. Specifically:

1. There is a considerable and responsible difference of opinion about the market which might exist for the output of the proposed new corporation. As you know, the Coalition's own consultant at one time expressed the opinion that, under certain assumptions, the commercial market for the project could be viable. He has recently provided a written opinion that those assumptions may not be reasonable in light of the proposed merger between Lykes and LTV, and that some additional and aggressive marketing strategy will be necessary. Therefore, further work in the marketing area is needed to complete the Coalition's study.

2. Because the pending merger between Lykes and LTV has not yet been consummated, we do not know which facilities would be available for sale. Consequently, there is no reliable information on the price and conditions under which facilities not needed by the merged company would be made available to others.

3. According to the Ecumenical Coalition's consultant's report, the viability of the proposed new corporation would be dependent to a substantial degree on the availability of directed Federal procurement. Several questions have been posed as to the legality and practicality of the government's directing a substantial amount of Federal procurement of products produced by the proposed new corporation. The Office of Legal Counsel in the Department of Justice is reviewing these matters and will report the results of its review to Mr. Hall.

4. The Coalition's consultants have requested additional funds to continue their studies, with particular concern for questions of markets, including Federal procurement and financing. These additional funds are being made available by the Department of Housing and Urban Development. Clearly the results of this additional study are essential to any decision on the economic viablity of the Coalition's proposal.

We shall continue our consideration of this proposal, and will have a decision as soon as the necessary information is in hand.

Moreover, we will continue to reserve $100,000,000 of our authority to guarantee loans for steel-producing facilities for a viable project in the Mahoning Valley.

National Steel Center

We are also proceeding in our consideration of the National Steel Center concept which has been advanced by the Mahoning Valley Economic Development Council. Last month, the Economic Development Administration granted funds to a number of universities to study the feasibility of technological innovations to restore the competitiveness of industries adversely impacted by imports. One of these grants went to Lehigh University to study technological innovations in the steel industry. As a result of our meeting three weeks ago, we have directed Lehigh University to include in its work program a specific study on the feasibility of utilizing a Mahoning Valley site for the conduct of development programs appropriate for the steel industry.

We will direct that this study be completed on a priority basis and the results provided to the Interagency Coordinating Council.

Unit Train

Our preliminary studies of the unit train concept serving all the steel producers in the Mahoning Valley reveals that its success will be dependent upon a complex set of investments and decisions to be made by a number of individual corporations and public bodies. Making and coordinating all these decisions will not be easy, and will not come quickly. But we will continue to pursue the possibility with all the parties involved.

Joint Blast Furnace

As you know, the proposed joint blast furnace concept depends on the use of the furnace by all of the principal steel producers in the area. The Republic Steel decision to install electric furnace facilities, while beneficial to the Valley, removes an important potential participant in the joint venture. Moreover, although we cannot be completely sure of what the new Lykes-LTV company will require by way of facilities of this type in the Mahoning Valley, it is probable that the new company would not need to participate in the venture, either. We have been advised by the author of the study that, given the uncertainties of these potential and major participants, the proposal is no longer feasible.

- - - - -

Let me sum up for you where we stand on the several proposals before us and our response:

(1) The proposal for the community-based steel corporation is still under consideration. The Department of Housing and Urban Development is supporting additional work by the Coalition's consultants to provide us with additional information. We are advised that this material will be available in about three months. In addition, we will be continuing our own investigations, and we promise expedited action and a prompt response as soon as we have sufficient facts.

(2) The proposal for the research and development site is being looked into in a responsible and prompt fashion by Lehigh University, and we will make a decision on a priority basis. We expect to have this material by March 1, 1979.

(3) We will continue to work with all interested parties on the unit train proposal.

(4) We do not anticipate any further work with regard to the joint blast furnace proposal.

I am sure you are aware that these proposals and our response to them do not constitute all of what the Federal government is doing to help the people and the governments of the Mahoning Valley recover from the impact of the Youngstown Sheet and Tube layoffs. Perhaps it will be helpful to review these other actions.

-- The Economic Development Administration has granted $600,000 to the Mahoning Valley Economic Development Council to prepare a comprehensive economic development strategy and to carry out an industrial development program. The work program for that grant is being approved and released this week. We are confident that this effort will bring new industries into the Valley.

-- We are acutely aware of the fact that many of the laid-off workers are now exhausting their benefits under the Trade Act, but that these benefits can be extended under the law if training opportunities are available to them. The Departments of Labor and Commerce are working with local vocational training and manpower offices to arrange for additional training slots. A plan of action will be developed shortly.

-- Some months ago, the Economic Development Administration approved the establishment of a $1,000,000 revolving loan fund, to be administered by the Western Reserve Economic Development Agency, with the cooperation of other agencies, to help local business maintain or expand employment. I am happy to report this program is now open for business.

Although the individual actions we have taken to date do not, by themselves, compensate for the impact of the Sheet and Tube layoffs; taken together, they are a significant federal response to the economic problems faced by the Valley. We also hope that we will have additional effective responses, as we continue to give priority attention to the proposals before us.

I know that I speak for the President, and for all the members of the Interagency Coordinating Council, when I tell you that we welcome and appreciate your leadership in this matter. We will continue the priority attention being given to finding solutions to the economic problems of the Mahoning Valley. Your continuing help is essential to the success of these efforts.

Sincerely,

Jack H. Watson, Jr.

JHW/mt

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Economic Development
Washington, D.C. 20230

MAR 2 9 1979

The Most Reverend James W. Malone
Chairman, Executive Committee
Ecumenical Coalition of the Mahoning Valley
263 Federal Plaza West
Youngstown, Ohio 44503

Honorable Phillip Richley
Mayor of Youngstown
Youngstown, Ohio 44503

Gentlemen:

As Chairman of the Interagency Task Force appointed by Jack Watson to study the proposals submitted by the City of Youngstown and the Ecumenical Coalition of the Mahoning Valley, I am writing to inform you of our conclusions.

Although the Coalition's Plan is presented in three phases, we have evaluated the proposal for the first two phases as a single project, since almost everyone concerned agrees that Phase I is not viable for more than a few years without Phase II. In addition, since the first phase of the project would not involve steel-making facilities, it would not qualify for the program, which was established for basic steel producers. Only by including the proposed steel-making facilities in the project, can we qualify it for consideration at all.

The principal and overriding difficulty we have with your proposals is the eventual requirement for EDA guarantees of some $245 million, a sum which is well in excess of the $100 million amount which had been set as the maximum loan guarantee for any one company under the special steel program.

It may be helpful to review the history of the steel loan guarantee program, so that all concerned can better understand why it is virtually impossible to provide a guarantee of this amount. The possibility of a steel loan guarantee program was first raised in connection with the so-called Solomon Report, transmitting the findings of the Federal government in response to the serious problems facing the

United States steel industry. The proposal to use the EDA program was somewhat unconventional since it proposed to use a revolving fund which had never previously been used to make or guarantee loans. Moreover, the scale of the program encompassing loan guarantees of $500 million for a single industry, was far in excess of EDA's previous experience. It was agreed by all those who had a part in the decision that the maximum EDA guarantee for any single company would be $100 million. Since that time, the Administration has further indicated its unwillingness to participate in large financing for private industry by limiting Federal participation to $50 million in programs other than steel, without Congressional approval.

Since the steel loan guarantee program went far beyond anything which had been envisioned at the time EDA's budget for the year had been approved by Congress, it fell within a provision in the reports of the appropriations subcommittees of both Houses which directed EDA to secure the approval of both appropriations subcommittees for any program changes which were significantly different from those which had been used to justify the budget. Where this approval was requested, both subcommittees required EDA to present testimony in justification of the steel program. EDA also testified on the program before the Trade Subcommittee of the House Ways and Means Committee.

Thus, EDA is on the record before Congress as well as the public at large with testimony stating that the agency would not approve any guarantees in excess of $100 million. It would be improper for EDA to approve $245 million in loan guarantees in the face of this record. This commitment to $100 million maximum formed the basis for my announcement last October that EDA would reserve $100 million in loan guarantees for a viable steel project in Youngstown. This commitment was confirmed by Jack Watson's letter of October 18, 1978.

EDA considered whether it ought to go to Congress and seek the approval of the appropriation subcommittees for the larger loan guarantees being sought in this instance. EDA has concluded that it should not go before Congress to seek approval for a project whose cost is so significantly in excess of the $100 million loan guarantee target and which lacks adequate assurance of economic viability.

It is important to note that the total amount in EDA's revolving fund presently stands in the neighborhood of $250 million, of which some $100 million is required as a reserve for existing loans, either approved or under consideration. This leaves something in the neighborhood of $150 million for the project in question.

While it has been EDA's practice to obligate 20% of the amount guaranteed as a reserve, that practice is based on a large number of guaranteed loans averaging somewhere in the neighborhood of $2 million. We believe that it would be improper to set aside a similarly small percentage where a single loan guarantee, by itself, could wipe out the entire revolving fund in the event EDA was required to reimburse the lenders as a result of default.

Moreover, we are not considering a project where the chances of default are minimal. For reasons stated below, the prospects of default in this case warrant caution in committing resources. In fact, we have grave doubts about the viability of the project. These doubts go to the following issues:

1. The availability of additional funds. We believe that the opinion of the Coalition's financial counsel is so carefully hedged and conditioned that we cannot rely on its assurances that financing can be obtained. Indeed, EDA's own experience in the administration of its steel loan guarantee program leads EDA to the conclusion that the necessary additional equity funding could not be obtained.

With $245 million in loan guarantees requested, EDA's regulations require an equity of 15 percent, or over $36 million in equity. Even if the proposed UDAG and EDA grants, totalling $27 million,were counted as equity, a practice of doubtful propriety, and even if it were possible to raise $3 million in private purchases of stock as proposed, the project would be short an additional $6.75 million in equity funds.

Moreover, we believe that the capital cost estimates may be considerably underestimated. The allowance for contingencies is less than one percent, which allowance is far below standard practice, and particularly dangerous for a project where there are no recent price quotes for the equipment to be purchased. If additional capital funds are needed, it will become even more difficult to secure the necessary private fund

2. The market study. While we agree with the general conclusion that the demand for steel will be strong in the years ahead, the only basic conclusion of the market study is that the reopened facility can sell its output if the price is competitive, the quality is good and delivery is reliable. It is our judgment that this means that the reopened facilities will regain markets slowly and over a long period of time as it establishes a reputation for a quality product and good delivery service. It is questionable whether the company will have the financial staying power to reach this point.

3. Management. While assurances have been provided that management is available, there is no documentation that a qualified in-depth management team can be assembled for this project.

4. Financial feasibility. We believe that the financial feasibility of the project rests largely upon assertions about increased labor productivity which cannot be documented. We admit that a strong case has been made, but the expectation for cost savings through increased labor productivity remains only a hope. The proposal puts too much at risk on the basis of this hope. The financial studies do not make allowances for cyclical swings in the steel industry and there is little likelihood that the weak financial posture of the new company could withstand any extended period of heavy losses due to a downturn in the steel industry.

It should be emphasized, however, that even if these doubts about the viability of the project were to be resolved by further work and research, the project, as presently conceptualized, cannot be funded under EDA's steel loan guarantee program because of the $100 million ceiling.

We recognize and are sensitive to the large amount of devoted, intelligent and skillful effort which has gone into the development of this project. There are few efforts more worthy of sympathetic support than those which go to the alleviation of unemployment, particularly when those who are unemployed have had so many years of faithful service to a particular industry. We commend the Ecumenical Coalition and the City of Youngstown for their valiant efforts to find a way by which the Campbell Works can be reopened. While we cannot encourage continued efforts along the lines of the present proposal, consistent with Jack Watson's letter of October 18, 1978, we are willing to continue to reserve $100 million of our authority to guarantee loans for a viable steel project in the Mahoning Valley, either in connection with the Campbell Works or on some other site. Jack Watson has asked that I advise you of his and my willingness to meet with you to discuss in detail the basis of our decision and alternative approaches to meet the needs of the Mahoning Valley.

We stand ready to work with the Coalition and the City to develop and find appropriate financing for other proposals directed toward the alleviation of the area's unemployment. It should be noted here that EDA has provided $700,000 for the preparation and administration of an economic development recovery plan. A revolving loan fund of $1 million to help small business has been made available to the Western Reserve Economic Development Agency. A number of proposals for new industries in the area are under consideration, and we plan to continue working closely with you and other local leaders to bring these proposals to reality.

EDA is also supporting activities which deal with the long range future of steel production in the Mahoning Valley. These include research on coking capability, direct reduction facilities and establishment of a research center utilizing the available blast furnaces. It is still too early to know whether any of these proposals are viable, and if so, when they can be put into operation.

While it is disappointing to realize, after so much effort and community commitment, that there seems to be no viable plan for the reopening of the Campbell Works, we believe that these other efforts can result in restoration of economic health to the Mahoning Valley.

To that end, we pledge continued cooperation and support from the Federal agencies. We will continue to work with you and with other community officials and leaders to attain our common goal -- the relief of excess unemployment in the Mahoning Valley. If you desire to meet with us, please call me at 202-377-5081.

Sincerely,

/s/ Robert T. Hall

Robert T. Hall
Assistant Secretary
for Economic Development

copy

THE WHITE HOUSE
WASHINGTON

May 9, 1979

Gentlemen:

This is in response to your letter and discussion paper of April 3rd. All of the issues raised in those two documents were discussed in varying degrees in our meeting of April 3rd.

First, I must disagree with your assertion that I, or anyone else in this Administration, committed up to $300 million in government guaranteed loans for a viable steel project in Youngstown. As my October 18, 1978, letter clearly states, we reserved and comitted up to $100 million for a viable steel project in the Mahoning Valley. I also am assured that you and your consultants and advisors were reminded of this limit by representatives of EDA. As I mentioned in our meeting, the total amount allocated for FY 1979 for steel projects is only $500 million. We never acted on the assumption that a full sixty per cent of that amount would be awarded to a single project.

Second, you believe you did not receive "the benefit of a genuine consultative process in developing" your project. Again, I must take exception. As I understand it, you and your representatives had numerous meetings, telephone conversations and exchange of letters and documents with both EDA and White House representatives. Based on questions raised and requests for additional information, your proposals were changed or modified several times. To my knowledge, no request for a meeting was ever refused you by EDA. It is clear to me that additional consultation would not have changed the facts in the situation or, therefore, the final decision. I believe my colleagues in the government worked hard to hear and understand your proposals and did consult with you in the process.

MAY 1 [illegible]

Third, you take exception to our questioning the viability of your proposal and suggest that no serious effort was made to explore matters about which there was doubt. I must respectfully disagree. Up until the meeting held at EDA on March 22nd, the data you had to support your proposal were changing. Indeed, on that date several adjustments were made. There came a point when a decision was necessary. EDA concluded, based on all the information it had before it, your project was not viable or economically feasible. Of course, the possibility remained that you could continue to refine the project to a point where it would be viable and economically feasible. However, based on our best evaluation of the data before us on March 29th, the project met neither of these criteria.

Fourth, you raise the possibility of separating Phase I of the project from Phase II and financing the latter without government guarantees. Although I understand some of your advisors believe that Phase I can stand on its own, the Department of Commerce believes the two phases are inseparable. Moreover, Phase I is not eligible under EDA guidelines by itself because the new company would not be a producer of basic steel. You will recall that my letter of October 18, 1978, referred to our commitment for "steel-producing" facilities. However, you certainly would be free to pursue private financing for Phase II along with Phase I. Were such financing committed, it might remove objections on our part to the amount of loan guarantees requested from the Federal government and the lack of private investment. You would still need to establish the viability of the overall project and meet the requirement that the loans be made only to basic steel producing companies.

Fifth, in response to your request that the Coalition receive a technical assistance grant to pursue new approaches, I am advised that EDA has committed its technical assistance funds for FY 1979. You can discuss the possibility of technical assistance using FY 1980 funds. These would be available after October 1, 1979, and any such project would be contingent upon an agreement with EDA on the scope of work, the objectives and the cost. To pursue this further, you should deal directly with EDA.

Sixth, with regard to the series of questions you posed that deal with the national significance of your proposal, you should be aware that the steel loan guarantee program was created to help the basic steel industry modernize, install pollution control equipment and, thereby, equip itself to withstand import competition. I do not think that it is in the national interest to take almost half of the amount authorized for this program and place it in one project. Although we understand your disappointment, when resources are scarce difficult choices must be made.

Finally, I would like to respond to your inquiry about President Carter's involvement in the decision to reject your proposal. As I stated at our meeting, the President was fully aware of the proposal and of our decision to reject EDA funding of it. He had delegated responsibility for oversight and coordination of the federal review of the matter to me.

We are, of course, interested in hearing from you regarding your plans for the future. For the time being, we continue to reserve $100 million of our loan guarantee authority for a viable steelproducing project in the Mahoning Valley. If you intend to pursue this project further, please contact Assistant Secretary Hall and let him know of your plans.

In conclusion, I reiterate our commitment and desire to continue to work at broadening the economic base and restoring the economic health of the Mahoning Valley.

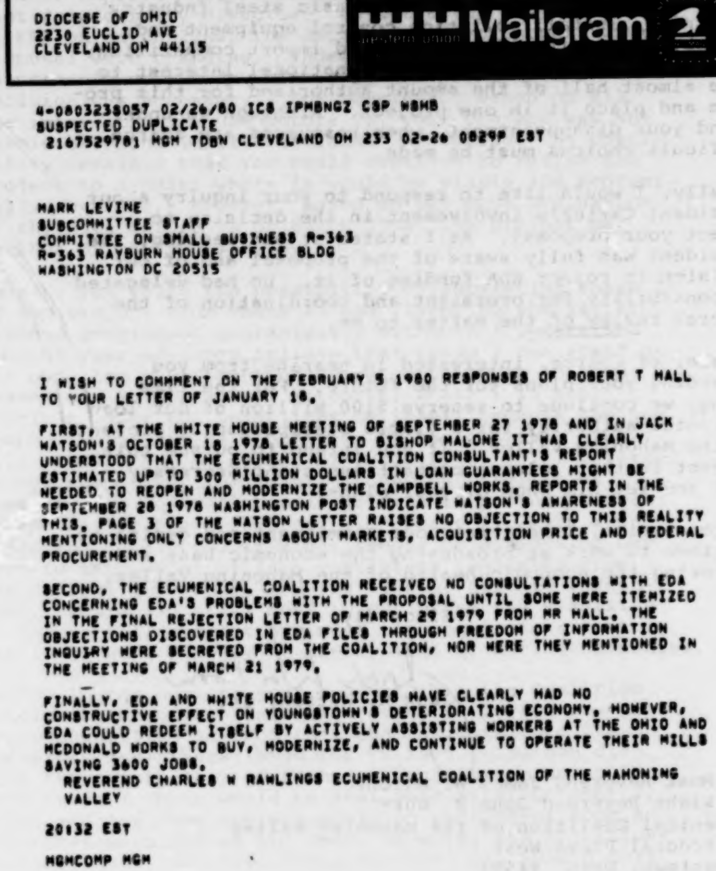
Sincerely,

Jack Watson

Jack H. Watson, Jr.

The Most Reverend James W. Malone
The Right Reverend John H. Burt
Ecumenical Coalition of the Mahoning Valley
263 Federal Plaza West
Youngstown, Ohio 44503

Appendix V.—Ecumenical Coalition Response to EDA



DIOCESE OF OHIO
2230 EUCLID AVE
CLEVELAND OH 44115

4-0803238057 02/26/80 ICS IPMBNGZ CSP WSHB
SUSPECTED DUPLICATE
2167529781 MGM TDBN CLEVELAND OH 233 02-26 0829P EST

MARK LEVINE
SUBCOMMITTEE STAFF
COMMITTEE ON SMALL BUSINESS R-363
R-363 RAYBURN HOUSE OFFICE BLDG
WASHINGTON DC 20515

I WISH TO COMMMENT ON THE FEBRUARY 5 1980 RESPONSES OF ROBERT T HALL TO YOUR LETTER OF JANUARY 18,

FIRST, AT THE WHITE HOUSE MEETING OF SEPTEMBER 27 1978 AND IN JACK WATSON'S OCTOBER 18 1978 LETTER TO BISHOP MALONE IT WAS CLEARLY UNDERSTOOD THAT THE ECUMENICAL COALITION CONSULTANT'S REPORT ESTIMATED UP TO 300 MILLION DOLLARS IN LOAN GUARANTEES MIGHT BE NEEDED TO REOPEN AND MODERNIZE THE CAMPBELL WORKS, REPORTS IN THE SEPTEMBER 28 1978 WASHINGTON POST INDICATE WATSON'S AWARENESS OF THIS, PAGE 3 OF THE WATSON LETTER RAISES NO OBJECTION TO THIS REALITY MENTIONING ONLY CONCERNS ABOUT MARKETS, ACQUISITION PRICE AND FEDERAL PROCUREMENT.

SECOND, THE ECUMENICAL COALITION RECEIVED NO CONSULTATIONS WITH EDA CONCERNING EDA'S PROBLEMS WITH THE PROPOSAL UNTIL SOME WERE ITEMIZED IN THE FINAL REJECTION LETTER OF MARCH 29 1979 FROM MR HALL, THE OBJECTIONS DISCOVERED IN EDA FILES THROUGH FREEDOM OF INFORMATION INQUIRY WERE SECRETED FROM THE COALITION, NOR WERE THEY MENTIONED IN THE MEETING OF MARCH 21 1979,

FINALLY, EDA AND WHITE HOUSE POLICIES HAVE CLEARLY HAD NO CONSTRUCTIVE EFFECT ON YOUNGSTOWN'S DETERIORATING ECONOMY, HOWEVER, EDA COULD REDEEM ITSELF BY ACTIVELY ASSISTING WORKERS AT THE OHIO AND MCDONALD WORKS TO BUY, MODERNIZE, AND CONTINUE TO OPERATE THEIR MILLS SAVING 3600 JOBS,
REVEREND CHARLES W RAWLINGS ECUMENICAL COALITION OF THE MAHONING VALLEY

20:32 EST

MGMCOMP MGM

Appendix W.—Material Obtained From EDA Through the Freedom of Information Act Request of the Ecumenical Coalition

BRIEFING PAPER ON YOUNGSTOWN/MAHONING VALLEY

The first part of this paper outlines EDA's adjustment assistance involvement in the Youngstown/Mahoning Valley area for the past three years. The second discusses the Campbell Works. The third part lists organizations and coalitions active in the area currently. The final section reviews EDA's plans for future involvement with Youngstown.

I. Steel Adjustment Assistance Projects Funded by EDA[1]

(1) APPLICANT:	Western Reserve Economic Development Agency (WREDA)
EDA $:	$[illegible]00,000
DATE APPROVED:	June 20, 1975
PURPOSE:	To develop an economic adjustment strategy in response to threatened job losses in basic steel and related support sectors.
STATUS:	The strategy was completed and served as the basis for a subsequent implementation grant to WREDA.
(2) APPLICANT:	Western Reserve Economic Development Agency (WREDA)
EDA $:	$1,627,870
DATE APPROVED:	September 14, 1976
PURPOSE:	Implementation grant for strategy formulated by WREDA under Title IX development grant (see above) to prevent loss of steel related jobs. Three parts are: 1. organize experimental unit trains to investigate possible transportation cost reductions; 2. analyze feasibility of a common blast furnace; and 3. institute a "supplemental income benefits plan" for local communities, to help them maintain essential services by creating a $1.2 million Community Insurance Fund.

---

[1] EDA Fudning since 1/1/77:
a. Regular program (excludes Title IX and LPW II) $5,696,800
b. LPW (Round II) $12,373,247

STATUS: 1. Preliminary plan for use of unit train (prepared by George Beetle) completed June 16, 1978. WREDA is negotiating with the railroads over the best manner in which to implement this plan. Outlook uncertain.

2. Feasibility study of common blast furnace (prepared by Industrial Economic Research Institute, Fordham University) completed June 1978. Under discussion with steel companies. Outlook uncertain.

3. On June 28, 1978, the project budget was amended to eliminate the Community Insurance Fund (which was made unfeasible when Youngstown Sheet and Tube closed before the Fund had been established). A total of $1 million will now be used to establish a local revolving loan fund, to be administered by a broad based Loan Fund Managing Committee, which will include the president of WREDA, the president of Mahoning Valley Economic Development Committee, an at-large member chosen by the rest of the Committee, the director of EDATA, the president of CASTLO, the president of the Trumbull County Community Improvement Corporation, and the president of the Mahoning County Community Improvement Corporation.

A trust is being established to administer the fund. It is expected to be in place early in October.

The revolving fund will be used for investments that will support economic adjustment efforts in the Mahoning Valley by creating and retaining jobs.

(3) **APPLICANT:** Mahoning County Commissioners

EDA $: $100,000

DATE APPROVED: February 1, 1978

PURPOSE: To develop an economic adjustment strategy to alleviate severe economic conditions that have arisen in the Mahoning Valley as a result of the area's narrow industrial base, effects of the recession, the energy crisis, and the substantial loss of metals-related jobs. The primary recent dislocation was the shutdown of the Youngstown Sheet and Tube steel mill.

STATUS: Prepared by Battelle Memorial Institute and completed in March 1978. Pending $600,000 project for the Mahoning Valley Economic Development Corporation will include a component under which this strategy will be refined and incorporated into a Comprehensive Economic Development Strategy (CEDS) for the area.

Pending Project

(4) **APPLICANT:** Mahoning Valley Economic Development Committee (MVEDC)

EDA $: $600,000

PURPOSE:

- Development and implementation of a Comprehensive Economic Development Strategy (CEDS) for the metropolitan area. (This is the only metropolitan CEDS in EDA's CEDS demonstration.) The CEDS will refine and incorporate the economic adjustment strategy prepared by Battelle Memorial Institute for Mahoning County.
- Assistance to the CASTLO Community Improvement Corp. (representing Campbell, Struthers and Lowellville) to provide those communities with the institutional capacity to participate in the design and implementation of the CEDS. (Two year funding.)
- Establishment of a staff capability and effort on the part of MVEDC to recruit new and expanded industry into the area. (Two year funding.)

STATUS: Project being processed in Midwestern Regional Office. Will be forwarded to Washington for approval by September 15, 1978.

II. The Campbell Works

The announcement of the closing of the Campbell Works and the year end lay-off of 4,800 of its employees on September 19, 1977, has drawn a great deal of attention to the Mahoning Valley in general and Youngstown in particular. The situation in the aging steel-making area is complicated by the numbers of individuals and groups from the political, religious, labor, private industry and public sectors who have been involved in a variety of attempts to keep the steel industry in the Valley and/or to diversify the Valley's economy.

The Campbell Works is one of the Youngstown Sheet and Tube facilities, located in Campbell, Ohio, adjacent to Youngstown employing 6,000 people before September 1977. The shaky financial condition of the Lykes Corporation, Youngstown Sheet's parent company, the unprofitable nature of the Campbell Works itself and the further expenditures required to meet EPA air and water standards precipated Lykes' decision to close Campbell with the exception of the seamless pipe mill. Although government assistance had been given in previous years to various groups to research the needs and problems of the Valley's againg steel making facilities and to research strategies for diversifying the Valley's economy, the Campbell closing came as a shock to many and aroused indignant reactions from Valley citizens who believed that Lykes had acquired Youngstown Sheet to milk it for profits and abandon it when they disappeared. The Campbell Works is now the property of the merged company, Jones/Laughlin (LTV), which apparently will not reopen what has been closed since it would compete with other company facilities. Moreover, the merged company has stated that it intends to close the remaining Youngstown facilities (Campbell Seamless Pipe mill and Brier Hill facility) in 18 months. This will mean an additional 1,800 jobs lost.

II. Organizations and Coalitions

There are four organizations and three coalitions which have been most active historically in attempting to find solutions to Mahoning Valley's problems. Each one will be listed separately along with its purpose, current status, visibility and importance.

Organizations

United Steel Workers of America, Youngstown District No. 26 covering 3 counties. Its origin and purpose is the improvement of working conditions and retention of jobs for steel workers. The District's three union locals are currently in relatively minor financial straits due to loss of dues and payments made to members who have been laid off. The union has been active in a number of coalitions and organizations. Its activist postures, its District membership of 80,000 and the attention of its national officers during this critical time make it an important actor. Jim Griffin, Assistant to the President of the Union and a retired steel worker has been very visible in the Youngstown situation.

Western Reserve Economic Development Agency (WREDA) is a multi-jurisdictional agency established several years ago to do economic development planning and implementation of some of its plans through negotiations and management of various development activities. WREDA's president, Bill Sullivan, has been politically controversial from time to time. WREDA has received several EDA grants to promote stabilization and diversification of the economy. It is very visible and seems well connected with the union, key religious leaders and private industry.

Mahoning Valley Economic Development Committee (MVEDC) established in late October of 1977 to attempt to unite the many political factions which exist throughout the Mahoning Valley and to focus national attention on Youngstown's problems. Set up by Congressman Carney and chaired by Mayor Richley of Youngstown, MVEDC has not been particularly visible as an organization until recently when it made application for EDA funds to hire a staff of development specialists whose first job will be to write a Comprehensive Economic Development Strategy (CEDS). EDA will fund MVEDC before the end of September 1978. MVEDC's broad political base makes it a relatively important organization.

National Center for Economic Alternatives (NCEA) a Washington based non-profit research organization established to investigate non-traditional methods of economic development. In October and November 1977, it began circulating a proposal to examine worker/community ownership of the means of basic production with the Campbell Works as the test case. The study was funded by HUD in January 1978 as part of its consideration of the problems of cities. The study has not been published yet. It was originally scheduled for publication in June 1978 but was withheld due to the Jones and Laughlin/Youngstown merger which undercut the study's economic feasibility assumptions for reopening the Campbell Works. Publication is now expected to occur in mid-September.

One of NCEA's principals, Gar Alperovitz, has been extremely visible both nationally and internationally as he has traveled widely in the past 6 months promoting the idea of religious groups' involvement in community ownership of basic manufacturing facilities. ~~NCEA is less important than the other organizations mentioned.~~ It will recommend ~~the unfeasible~~ solution of spending vast sums of Federal dollars ~~to reopen a facility~~ which will never regain its market share let alone be self-sustaining. Moreover, NCEA and its ideas are ~~strongly~~ opposed by the Steel Workers Union and by private industry.

Coalitions

Ecumenical Coalition of the Mahoning Valley, Inc. (ECMV, Inc.) established in October of 1977 to focus attention of the Valley's religious groups on the plight of the steel workers and the moral issues arising from massive layoffs. ECMV was an early supporter of NCEA's study and incorporated in December 1977 to receive funds from HUD in the capacity of project manager for the NCEA study. Funds were subsequently given directly to NCEA as the contractor. ECMV has been active in fund raising to provide equity to reopen Campbell and to impress the Federal government with its seriousness of purpose. Individual members of ECMV, Fr. Ed Stanton in particular, have maintained active roles in other organizations and groups seeking resolutions, and alternatives for Youngstown. ECMV is both highly visible and important given its constituency and activist role in the Youngstown situation.

Steel Communities Coalition (SCC) a dues paying membership organization of the 50 largest steel making communities in the Northeast which includes organized labor as a contributing voting member. It was established a year ago to explore alternatives to maintaining obsolete steel making facilities. It is currently pursuing some alternative strategies which it expects to be able to make public sometime this fall. Bill Sullivan, of WREDA, is President of SCC. Fr. Stanton of ECMV, Inc. has been an active participant in the Coalitions deliberations. The SCC has not been highly visible. It may become important if it is able to present viable alternatives to the problems currently besetting steel communities.

CASTLO is a coalition formed several months ago by the towns of Campbell, Struthers and Lowellville to represent their own interests to the Board of Directors of MVEDC. CASTLO has alleged that MVEDC has been concerned with Youngstown at the expense of these three communities which were more severely affected by the Campbell Works closing than Youngstown. The town of Campbell, for example, is nearly bankrupt from the loss of plant tax revenues. EDA has made CASTLO membership on the Executive Committee of MVEDC a condition of the Title IX implementation grant to be given to MVEDC by the end of this month (see part I). CASTLO is relatively new for it to have achieved much visibility. It is too soon to estimate the coalition's importance to the overall situation.

IV. EDA's Plans for Continuing Involvement

As detailed in opening paragraphs of this paper, EDA has been concerned with Youngstown's needs for the past three years. We have directed our investments to supporting the development of alternatives to the demise of the steel industry in the Valley and to the diversification through business and industrial development of the Valley's economy. We will continue to fund these activities so long as they continue to be productive.

In addition, several proposals have been advanced in the past year which involved the application of unproven steel producing technologies. ~~However, the results of feasibility studies on implementing~~ these technologies. However, the results of feasibility studies on implementing these technologies have not been encouraging. Further, no single group or organization capable of reopening the Campbell Works under any circumstances has yet emerged. Therefore, we have been unable under either the Special Steel Loan Guarantee Program or our regular Business Development program to pursue a viable project to a fundable conclusion.

We see a couple of possibilities for the emergence of viable projects. We may be able to support the outcome of work being done by the Steel Communities Coalition if they can successfully develop alternative strategies for dealing with steel mill closings. In addition to that, the work done by Fr. Bill Hogan to develop a method for unit train transportation of raw materials and the proposal for a joint venture coke oven and subsequent blast furnace will be discussed this fall with the steel companies essential to implementing the proposals. Some intelligence suggests that steel companies, especially in Mahoning Valley, are more sensitive than ever to the problems plant closings create and are moving cautiously in the direction of cooperative action with concerned parties to ameliorate the effects of layoffs and closings.

APPENDIX X.—ADDITIONAL MATERIAL RE EDA LOAN GUARANTEE ASSISTANCE TO WISCONSIN STEEL CORP.

BERKLEY BEDELL, IOWA
CHAIRMAN
[illegible]

United States House of Representatives
Committee on Small Business
Subcommittee on
Antitrust and Restraint of Trade
Activities Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

[illegible]

February 29, 1980

Mr. Robert T. Hall
Assistant Secretary
  for Economic Development
Department of Commerce
Main Building
Room 7800 B
Washington, DC   20230

Dear Mr. Hall,

Because of time considerations there were many areas we were unable to discuss when you appeared before the Antitrust Subcommittee on February 27. At that hearing I requested that the record remain open to allow the Economic Development Administration to reply to questions from the Subcommittee.

Our questions relate to EDA's loan and grant programs in general; and to our conversation about EDA's loan to Wisconsin Steel under your agency's special steel program. The questions we have that relate to your loan and grant programs follow.

1. EDA has assisted several sucessful employee purchases of divested subsidiaries. What factors does EDA look for that suggest the new project will be a success? What research has EDA performed to isolate these factors?

2. We understand that EDA has just 6 regional offices. Does this complicate your efforts to provide technical assistance for the loans you administer? Studies we are familar with show that smaller, riskier loans require significant amounts of technical assistance.

Our questions about EDA's loan to Wisconsin Steel under your special steel program follow.

1. We would like to know if anyone from your agency had contact with anyone from International Harvester before their sale of Wisconsin Steel to Envirodyne; and if there was any contact between your agency and International Harvester prior to EDA's approval of the loan guarantees to Wisconsin Steel.
If there was contact in either instance, we would like a history of that contact.

2. Was there any question raised, either in EDA's legal department or in the Commerce Department's legal section, about the legality of International Harvester assuming the 10% guarantee on the loans EDA made to Wisconsin Steel? If there was, we would like its history.

3. In the process of EDA's evaluation of Wisconsin Steel's loan application, was the question of who was liable for the pensions of Wisconsin Steel's employees, Envirodyne or International Harvester, raised? Where does that responsibility presently lie?

4. The question was raised during the hearing about the repayment schedule on the loan to Wisconsin Steel in the case of default. We would like to know where the government stands in relation to other lenders, and the amount the government presently has committed to Wisconsin Steel.

5. What is the current outstanding balance on the $50 million mortgage loan International Harvester made to Envirodyne to facilitate the sale and purchase of Wisconsin Steel?

We realize the questions posed in the first part of this letter require thought and research on your part. We are prepared to receive your answers within a reasonable time frame. Because of the nature of the questions raised relating to the loan to Wisconsin Steel, we suggest that you give them first priority. We are expecting your response to those issues as soon as possible. If you have any questions about the issues raised in this letter, please contact our staff member, Mark Levine, at 225-8944.

Sincerely,

Berkley Bedell

BB:mjl

INSERTION FOR THE RECORD

Hearings before the

COMMITTEE ON SMALL BUSINESS
Subcommittee on Antitrust and Restraint of Trade Activities
Affecting Small Business

U. S. HOUSE OF REPRESENTATIVES

Conglomerate Mergers
and their Effect upon
Local Communities and Small Businesses

February 27, 1980

Question:

EDA has assisted several successful employee purchases of divested subsidiaries. What factors does EDA look for that suggest the new project will be a success?

Answer:

Each of the five EDA-funded employee stock ownership plans [ESOPs] have been companies that have been divested by a major conglomerate. Among the universe of conglomerate divestitures, there is a very narrow band of potentially viable ESOPs.

At the top of the scale, few highly profitable companies are divested, and those that are divested can be (and usually are) easily sold to other companies as ongoing operations. At the lower end of the scale, a large number of divested companies cannot be profitable under any form of enterprise ownership.

Marginally profitable or marginally unprofitable firms sometimes can be made viable under an ESOP arrangement. Key factors that tend to make a marginally profitable/unprofitable firm viable under an ESOP arrangement are:

- the tax savings that are available to employee stock ownership trusts [ESOTs] (the entire contribution to the trust, i.e., interest and principle, is tax deductible); and
- the amount of overhead that the subsidiary contributed to the conglomerate (often this contribution is substantially more than would be required if the subsidiary were operating as an independent company);
- the management (an indication that experienced, on-going management is available); and
- the indication that productivity will increase (this is a very difficult factor to assess and cannot be relied upon to significantly influence the future profitability of the company).

Question:
What research has EDA performed to isolate these factors?

Answer:
EDA has sponsored three studies which provide insight into the factors contributing to successful employee purchases of divested subsidiaries:

- a Program Analysis report entitled "Source Bibliography [of] Employee Stock Ownership Plans (ESOP)" containing a comprehensive listing of ESOP references along with brief summaries of periodical and newspaper articles;
- a Technical Assistance report entitled "Employee Ownership" consisting of an analysis of several ESOP case studies including one owned exclusively by employees; and
- a Research Division grant supported by the Office of the Secretary (Department of Commerce) which funded a Harvard University study under the direction of Belden Daniels to complete the following reports:
  - -- "Preliminary Exploration of the Impact of Acquisition on the Acquired Firms", which includes several case studies one of which discusses a firm that was initially acquired by a conglomerate and later sold to its employees;
  - -- "Capital Markets and Small Enterprise"; and
  - -- the potential for revitalization of mature firms under new forms of ownership, a study that was to have investigated that issue but was never completed.

Although none of the completed studies specifically addressed the factors effecting successful employee purchases, certain of the case study findings appear to be relevant.

Question:
We understand that EDA has just six regional offices. Does this complicate your efforts to provide technical assistance for loans you administer? Studies we are familiar with show that smaller, riskier loans require significant amounts of technical assistance.

Answer:
Clearly, EDA's small staff has always affected the degree to which the Agency is able to respond to the need of all applicants, including borrowers. Budgetary and staff ceilings have made substantial expansions impossible. Nevertheless, we believe we have been able, with our small staff, to provide certain basic assistance to firms which are applying for or have received EDA loans or loan guarantees. This has been accomplished through our current six regional offices. With the enactment of EDA's new legislation, we will expand to ten Federal regions which should aid in providing even better assistance to potential borrowers.

It is also important to bear in mind that EDA's University Centers, which currently receive $3 million in Technical Assistance funds, were established to provide such service to area businesses. The centers provide technical and managerial assistance as well as package loans. In addition, for EDA borrowers under the Trade Act, EDA also provides technical assistance, especially through its network of ten Trade Adjustment Assistance Centers.

Question:

We would like to know if anyone from your agency had contact with anyone from International Harvester before their sale of Wisconsin Steel to Envirodyne; and if there was any contact between your agency and International Harvester prior to EDA's approval of the loan guarantees to Wisconsin Steel. If there was contact in either instance, we would like a history of that contact.

Answer:

According to EDA records and staff recollections, there was no contact with either International Harvester or Envirodyne officials before the sale of Wisconsin Steel to Envirodyne. In fact, the sale occurred prior to the establishment of the Steel Loan Guaranty program administered by EDA.

There was, however, contact with International Harvester representatives prior to EDA's approval of the loan guarantees to Wisconsin Steel. The first contact occurred in late November, 1978, more than a year after the sale of Wisconsin Steel to Envirodyne and more than six months after Envirodyne officials first approached EDA for assistance.

Since late 1978, there were numerous meetings, telephone conversations and correspondence relating to the loan guaranty approvals in August, 1979. The contacts involved issues concerning I-H subordination of its collateral, indemnification of EDA for shortfall of collateral, the extension of credit by Chase Bank and others, and the form of the documentation for the loan guarantees and related instruments.

Question:

Was there any question raised, either in EDA's legal department or in the Commerce Department's legal section, about the legality of International Harvester assuming the 10% guaranty on the loans EDA made to Wisconsin Steel? If there was, we would like its history.

Answer:

No such question was raised. The EDA Office of Chief Counsel reviewed the issue of International Harvester's guarantee of 10% of the Wisconsin Steel loans (that portion not guaranteed by EDA) and concluded that this satisfied the letter and intent of the statutory requirement that no EDA guarantee ". . . shall at any time exceed 90 percentum of the amount of the outstanding unpaid balance of such loan," as provided in Section 202(a)(1)(C) of the Public Works and Economic Development Act of 1965, as amended (42 USC 3142).

Question:

In the process of EDA's evaluation of Wisconsin Steel's loan application, was the question of who was liable for the pensions of Wisconsin Steel's employees, Envirodyne or International Harvester, raised? Where does that responsibility presently lie?

Answer:

The question of who would be liable for the pensions was raised. EDA has been informed that the primary responsibility lies with a subsidiary of Envirodyne Industries, Inc., but that International Harvester has some contingent liabilities for at least a portion of the unfunded vested pension benefits. According to the 1979 Annual Report of International Harvester (at page 20):

> "The Company [International Harvester] remains contingently liable to certain obligations assumed by the purchaser of the Company's former Wisconsin Steel Division. These obligations include . . an undetermined portion of unfunded vested pension benefits. The unfunded vested pension benefits liability for participants under the plans covered by this contingent liability was approximately $66 million as of January 1, 1977, and was reported as $43.5 million by the purchaser in its 1978 financial statements. If the purchaser is unable to provide benefits due under the various pension plans, the Company would not be required to make any payments for vested benefits until after the trust assets have been exhausted, the purchaser has made any required payments and the Federal Pension Benefit Guaranty Corporation has made all payments required by law. If the Company is not required to make any payments of such vested pension benefits by July 31, 1982, its commitments provide that a substantial portion of any remaining contingent liability shall terminate on that date."

Question:

The question was raised during the hearing about the repayment schedule on the loan to Wisconsin Steel in the case of default. We would like to know where the government stands in relation to other lenders, and the amount the government presently has committed to Wisconsin Steel.

Answer:

There are two outstanding EDA guaranteed loans to EDC Holding Company for Wisconsin Steel:

- a $75 million Fixed Asset Loan ($40 million disbursed), with semi-annual payment of interest only beginning May 1, 1980, principal and interest payments beginning in 1982, and final payment in November, 1999; and
- a $15 million Working Capital Loan (all disbursed) with quarterly payments of interest only beginning February 1, 1980, principal and interest payments beginning July, 1981, and final payment in February, 1986.

In the event of default, payment of the full outstanding balance may be accelerated and immediately due. Should that occur, EDA would expect to be called upon to honor its guaranty to the note-holders for 90% of the balance the borrower is unable to repay. EDA would then, by subrogation, assume 90% of the lenders' interests in the collateral securing the guaranteed loans. This includes a first lien on most of the borrower's real and personal property, including the steel mill itself, ahead of all other creditors, and a junior lien on inventory and receivables, behind a revolving line of credit extended by Chase Bank (in addition to Chase's guaranteed working capital loan to the borrower). International Harvester, which has a lien on ore and coal properties of the borrower (on which the lenders under the EDA guaranteed loans have no lien), subordinated (to the EDA guaranteed loan) its lien on the borrower's fixed assets securing the "mortgage loan". International Harvester also has agreed to indemnify EDA if there are any defects in the borrower's title to the Wisconsin Steel mill property, and further to indemnify EDA up to $27 million (over a period of up to 20 years) if there is insufficient collateral upon liquidation for EDA to recover its guarantee payments.

EDA's maximum exposure on its guarantees of disbursed loan funds is 90% of the $55 million, plus any unpaid interest. The amount of EDA's present commitment to Wisconsin Steel, measured by EDA's maximum exposure, is thus approximately $51 million. This amount is more than offset by a conservative estimate of the amount EDA would recover from the proceeds of liquidation and the International Harvester indemnification. It is anticipated that there would be no loss to the U. S. Treasury of any of the guarantee payments EDA might be called upon to make.

Question:
What is the current outstanding balance on the $50 million mortgage loan International Harvester made to Envirodyne to facilitate the sale and purchase of Wisconsin Steel?

Answer:
EDA officials are informed the full $50 million secured Series A and B notes of EDC Holding Company (Envirodyne) to International Harvester remain outstanding. These notes were refinanced in conjunction with the EDA guaranteed loan closing on November 1, 1979, with repayment terms now calling for 18 level, annual payments on both series totalling approximately $7.2 million per year, beginning in November, 1982.

BERKLEY BEDELL, IOWA
CHAIRMAN

JAMES M. HANLEY, N.Y.
HENRY B. GONZALEZ, TEX.
RICHARD H. ICHORD, MO.
TONY P. HALL, OHIO
TOM STEED, OKLA.

United States House of Representatives
Committee on Small Business
Subcommittee on
Antitrust and Restraint of Trade
Activities Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

DAN QUAYLE, IND.
OLYMPIA J. SNOWE, MAINE
THOMAS J. TAUKE, IOWA

MARC H. ROSENBERG,
SUBCOMMITTEE PROFESSIONAL STAFF
DIRECTOR
[illegible]

[illegible]
MINORITY SUBCOMMITTEE PROFESSIONAL
STAFF MEMBER
[illegible]

April 14, 1980

TO: Hon. Berkley Bedell, Chairman

FROM: Mark J. Levine, Researcher
Marc H. Rosenberg, Staff Director

RE: WISCONSIN STEEL CO.

Introduction

In February of this year the Small Business Subcommittee on Antitrust conducted a series of hearings on conglomerate mergers and their effects on small business and local communities. A portion of those hearings was devoted to reviewing existing federal programs that may be of assistance to communities that have been affected by acquisitions, divestitures and plant closings.

Several programs administered by the Commerce Department's Economic Development Administration were discussed. Perhaps as a consequence of the Subcommittee's case study involving the Youngstown Sheet and Tube Company, there was particular interest in the EDA's special steel loan program.

EDA's administrator, Robert Hall, was questioned closely by the Subcommittee at its February 27 hearing. At an informal meeting on March 4 the Subcommittee unanimously accepted the chairman's proposal for further staff study of EDA's steel loan program, with specific cases to be examined.

Based upon information presented at the Subcommittee's conglomerate merger hearings, as well as additional information subsequently gathered by the staff, it was decided that a case study profile should be done on the Wisconsin Steel Company. This report seeks to outline briefly the recent history of WSC and its involvement with various federal agencies and programs.

The Wisconsin Steel Company

WSC is an integrated steel company, a relatively small one by industry standards. The company's main facility is its steel mill complex in the Chicago, Illinois, area. It also owns coal and iron ore mining operations. Employment has been in the 3800 - 4000 range in recent years.

The company was acquired by International Harvester (IH) in 1902 and operated as a wholly owned subsidiary for 75 years. Historically, IH has been the largest single customer for steel and steel products produced by WSC.

Throughout the 1970's WSC received numerous citations from the federal Environmental Protection Agency and the State of Illinois for various violations of pollution control laws. Substantial expenditure would be required to bring the plant into compliance with environmental protection laws.

Observers of the steel industry note that by the late 1960's IH had stopped making significant capital improvements at WSC. By the mid-70's the plant had become obsolescent and WSC appeared to be suffering substantial losses. Dun and Bradstreet reported that operations of WSC's steel mill "had been unprofitable for a number of years prior to (1977)."

Precise figures on WSC's operations under IH are difficult to ascertain, since the company was a division of a conglomerate that issues a single consolidated report for all of its operations. In 1978, the first calendar year after WSC was sold by IH, sales were $273 million. This is believed to be typical of sales in the preceding several years.

WSC Purchased by Envirodyne

For several years, International Harvester sought a purchaser for Wisconsin Steel. In August 1977 WSC was acquired by a newly formed subsidiary of Envirodyne Industries. The purchase price was $65 million.

Prior to the acquisition of WSC, Envirodyne's principal activity was consultation on high technology projects. For 1976, Envirodyne reported revenues of $21 million and earnings of $228,000. In that year, the company's assets were valued at $15.7 million and its net worth was set at $8.6 million.

Acquisition of WSC was accomplished without Envirodyne having to raise any capital. First, Envirodyne obtained a $50 million mortgage from International Harvester, the seller, secured by WSC's iron and coal mining properties.

Also, Envirodyne obtained $35 million in short-term notes from Chase Manhattan Bank (on bankers acceptance terms). This was collateralized by accounts receivable and inventory with a net book value of $46.3 million. $30 million of the $35 million line of credit had been drawn down by December 31, 1977.

cont'd

Part of the sale agreement was that IH was given the right to convert up to $10 million of the mortgage notes into Envirodyne common stock at $10 per share. (At the time of the sale, the stock traded at about $3. It reached a high of $6.5 per share in 1978. Approximately 5.4 million shares now are outstanding.) Envirodyne's Form 10-K filed with the Securities and Exchange Commission for 1979 includes this statement: "In the event that IH forecloses on any of the collateral for the notes, it is entitled to purchase the previously applicable number of common shares at an amount equal to 40% of the...per share price. All purchase rights terminate 180 days after any such foreclosure."

Another condition of the sale was that Envirodyne agreed to assume from IH substantial outstanding obligations relating to WSC, including those of the pension fund. Wisconsin Steel has a house union, the Progressive Steel Workers Union, and its employees are covered by their own pension plans. At the time of the sale, the pension fund had assets of approximately $35 million and unfunded vested liabilities of about $60 million.

Federal Government Financial Assistance

In 1977, at roughly the same time the sale of WSC was being negotiated, the Commerce Department was considering the so-called Solomon Report. This proposed a program of loan guarantees for small and medium sized, integrated steel producers, to give them access to capital needed for plant modernization.

In 1978 the special steel loan program was established, and Wisconsin Steel was one of the first applicants. Had WSC still been a subsidiary of International Harvester, a company with ready access to capital markets, it is doubtful that it would have qualified for participation in the new program. WSC's new parent, Envirodyne, was heavily in debt, and there appears to have been no problem convincing the Economic Development Administration that they needed help in obtaining financing.

On November 1, 1979, EDA signed an agreement guaranteeing loans to Envirodyne totalling $90 million. The loans were made by Chase Manhattan Bank and a consortium of six insurance companies led by Connecticut General.

EDA is not allowed to guarantee more than 90% of a loan. Before agreeing to lend the money needed by Envirodyne, the lenders required additional assurances for the unguaranteed portion of the loan. The International Harvester Company agreed to guarantee the uncovered portion of the loan.

Chase Manhattan Bank's share of this risk-free, 100% guaranteed loan was made at the floating rate of prime plus 1½ points. At the Subcommittee's February 27 hearing, the chairman observed that the prime rate is reserved for secure loans, and he challenged the justification for a 1½ point surcharge being assessed when the loan was fully guaranteed by the U.S. government and a multinational corporation.

cont'd

At the Antitrust Subcommittee's hearing on February 27, Members expressed considerable concern about the intent of Congress being violated by this loan agreement. The opinion was expressed that the purpose of the 90% cap on government loan guarantees is to assure that the lender retains some risk and thus is motivated to scrutinize the loan proposal and monitor the activities of the borrower. When 100% of the loan is guaranteed, there is less incentive for the lender to conduct critical reviews.

Also in 1979, the Department of Housing and Urban Development discussed with WSC and local government officials a program of financial aid for the steel company. By means of an earmarked loan to the City of Chicago, approved in February 1980, HUD made available $10 million in Urban Development Action Grant (UDAG) funds for the improvement of pollution control equipment at Wisconsin Steel. In keeping with UDAG program guidelines, the money was made available on the condition that WSC must first purchase and install the equipment, and then the company would be reimbursed. Consequently, the funds would not actually have gone to WSC until several years into their capital improvement program.

Wisconsin Steel unsuccessfully sought immediate access to the UDAG money. They proposed that some of the money be loaned to them for use as operating capital, with repayment promised to occur before reimbursement for pollution control equipment would be sought. Staff is informed that representatives of the Economic Development Administration actively supported this request by WSC. HUD resisted, though, maintaining that UDAG funds could not be used for operating capital.

In late February or early March 1980, Envirodyne approached EDA with a request for additional loan guarantees for WSC. The steel company estimated that it needed $25 million in new money for immediate use as working capital. We are told that EDA indicated they would consider guaranteeing about a third of the amount sought, provided that WSC first obtained the rest of the financing package from private sources. WSC was not able to put together the deal.

The Bankruptcy of Wisconsin Steel

On November 2, 1979 -- one day after the papers were signed for EDA's guarantee of the $90 million in loans to WSC -- the International Harvester Company's main plants were shut down by a long-anticipated strike by the United Auto Workers. The strike lasted five months. As noted before, IH was the largest single buyer of Wisconsin Steel's output.

Given Wisconsin Steel's history of unprofitable operation, it is clear that they were in trouble even without the IH shut-down. In its 1979 10-K report, Envirodyne said this about its WSC steel and mining operations: "...incurred substantial operating losses both prior to and subsequent to its acquisition by the Company, which losses have been accelerating in magnitude."

cont'd

WSC memo - p.5
April 14, 1980

In 1976, the calendar year prior to its acquisition of WSC, Envirodyne had earnings of $228,000 on revenues of $21 million. In 1978, the first full calendar year after it acquired WSC, Envirodyne showed a loss of $17 million on revenues of $274 million. (Losses in 1979 are reported to be $44 million.) Asset size had grown from $15.7 million in 1976 to $156.2 million in 1978, while net worth fell from $8.6 million to negative $10.7 million. Envirodyne's percentage of long-term debt to capitalization went from 21.55 to almost 90.

On March 28 the Wisconsin Steel Company was closed down as a result of actions taken by Envirodyne's creditors. On March 31 Envirodyne filed for reorganization of its steel and mining subsidiaries under Chapter 11 bankruptcy laws. Attached are copies of Wall Street Journal articles describing the plant closure and the filing for reorganization. An initial hearing under Chapter 11 procedings is scheduled for April 21.

The Pension Fund

The closing of Wisconsin Steel casts into question the status of the pension fund covering members of the Progressive Steel Workers Union. According to information provided by the Pension Benefit Guaranty Corporation, on January 1, 1979, an unfunded vested liability of $55.7 million existed. Roughly 4,000 workers were participating in the plan, and an additional 1,400 were receiving retirement benefits at that time.

Under the terms of the Employee Retirement Income Security Act (ERISA), the Pension Benefit Guaranty Corporation (PBGC) was established; it is required to step in and assume responsibility for the pension fund if WSC closes down. This will assure workers that they will receive at least some of the pension benefits they have earned.

ERISA provides that the PBGC can lay claim to up to 30% of the assets of a pension plan's parent company, in order to recover some of the costs PBGC incurs. The now-closed Wisconsin Steel Company constitutes over 90% of the assets of its parent company, Envirodyne. Moreover, heavy losses sustained by WSC in recent years have resulted in a negative net worth for the parent company.

Subsequent to its February 27 hearing, the Subcommittee posed the following question in a letter sent by Chairman Bedell to Robert Hall of the Economic Development Administration: "In the process of EDA's evaluation of Wisconsin Steel's loan application, was the question of who was liable for the pensions of Wisconsin Steel's employees, Envirodyne or International Harvester, raised? Where does that responsibility presently lie?"

cont'd

Mr. Hall responded, "The question of who would be liable for the pensions was raised. EDA has been informed that the primary responsibility lies with a subsidiary of Envirodyne Industries, Inc., but that International Harvester has some contingent liabilities for at least a portion of the unfunded vested pension benefits." He went on to cite the following statement found in International Harvester's 1979 Annual Report to shareholders.

> The Company (IH) remains contingently liable to certain obligations assumed by the purchaser of the Company's former Wisconsin Steel Division. These obligations include...an undetermined portion of unfunded vested pension benefits. The unfunded vest pension benefits liability for participants under the plans covered by this contingent liability was approximately $66 million as of January 1, 1977, and was reported as $43.5 million by the purchaser in its 1978 financial statements. If the purchaser is unable to provide benefits due under the various pension plans, the Company would not be required to make any payments for vested benefits until after the trust assets have been exhausted, the purchaser has made any required payments and the federal Pension Benefit Guaranty Corporaton has made all payments required by law. If the Company is not required to make any payments of such vested pension benefits by July 31, 1982, its commitments provide that a substantial portion of any remaining contingent liability shall terminate on that date.

It remains unclear to the Subcommittee staff whether International Harvester will, in fact, be compelled to make any payment toward the unfunded vested pension benefits liability of the pension fund. If the PBGC is required to cover a substantial portion of WSC's unfunded vested pension liabilities it will be the biggest payout in their history.

# # #

WALL STREET JOURNAL
March 31, 1980

Envirodyne's Unit Closes Down After Action by Harvester

By a WALL STREET JOURNAL *Staff Reporter*

CHICAGO—Wisconsin Steel Co., the financially troubled subsidiary of Envirodyne Industries Inc., closed down Friday after its former parent, International Harvester Co., resumed ownership of some of its iron and coal mining properties.

The five-month strike by the United Auto Workers against International Harvester, Wisconsin Steel's biggest customer, left Envirodyne and its subsidiary under considerable financial pressure. Harvester said its action of Friday was designed to relieve that pressure, but an Envirodyne spokesman called Harvester's moves the direct cause of Wisconsin Steel's closedown.

The foreclosed properties, which include coal mines in Benham, Ky., and partnership interests in two iron-ore mining and pelletizing operations in Michigan, were security for a $50 million loan from International Harvester through which Envirodyne acquired Wisconsin Steel from Harvester in 1977.

Under terms of the original agreement, an International Harvester spokesman said, the farm-equipment maker has resumed ownership of the properties because Envirodyne can't contribute funds to maintain its own partnership. The spokesman said that by resuming ownership of the properties, International Harvester also relieved Wisconsin Steel of obligations to cover operating expenses.

Following Harvester's action, the Chase Manhattan Bank ordered a halt to shipment of Wisconsin Steel inventories that had been used as collateral for a $35 million loan to the steel firm, according to a Chase vice president. It was Chase's move to "lock the company gates" that actually brought operations to a close on Friday, an Envirodyne spokesman said.

The Chase official, who asked not to be identified, confirmed that the bank had made its support of Wisconsin Steel contingent on Harvester's continued support of the company.

In Washington, Robert Hall, Assistant Secretary of Commerce for economic development, said Harvester's decision came as a surprise. He said in a prepared statement that the news came just as the Economic Development Administration was preparing for a meeting with Harvester to work out plans to keep Wisconsin Steel afloat.

He said the EDA will work to maintain and protect the Wisconsin Steel facilities, "so that they will be available to provide jobs for the employes of Wisconsin Steel in the near future under appropriate ownership and management." An EDA spokesman said that last fall, the EDA guaranteed 90% of a $90 million loan to Wisconsin Steel, $56 million of which already has been disbursed.

An Envirodyne spokesman said 3,400 employes of Wisconsin Steel have been laid off as a result of the closedown.

Last week, Envirodyne reported a 1979 loss of $44.1 million and reported that its auditors had raised doubts about the ability of Wisconsin Steel, which represents 93% of the company, to survive. The Envirodyne spokesman said that "at least $8 million" in government loans would be needed to keep Wisconsin Steel alive.

WALL STREET JOURNAL
April 1, 1980

Envirodyne Units Petition for Protection Of Chapter 11 Status

By a WALL STREET JOURNAL *Staff Reporter*

CHICAGO — Envirodyne Industries Inc. said that eight of its subsidiaries, including Wisconsin Steel Co., which closed its doors last Friday, have filed for reorganization under Chapter 11 of the federal Bankruptcy Act.

Envirodyne said the move was designed to make the subsidiaries eligible to receive assistance from the U.S. Economic Development Administration. In Washington yesterday, EDA officials were meeting with Envirodyne officials to discuss whether to provide the financially troubled company assistance to keep Wisconsin Steel alive.

On Friday, Wisconsin Steel's Chicago mill closed after International Harvester Co., its former parent, resumed ownership of some of its iron and coal mining properties. Envirodyne and Wisconsin Steel both have been under considerable financial pressure because of the five-month strike by the United Auto Workers union against Harvester, Wisconsin Steel's biggest customer.

Harvester had claimed that by resuming ownership of the properties, it was relieving Wisconsin Steel of some of its financial pressures. But Envirodyne charged that Harvester's action directly precipitated the closing and yesterday's Chapter 11 filings.

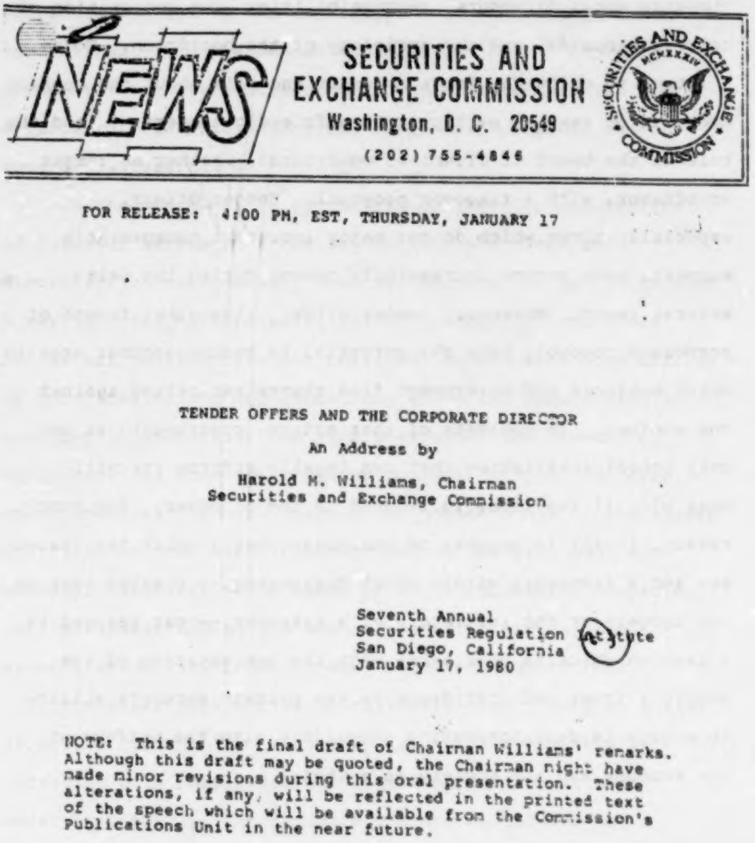
In Washington, an EDA spokesman confirmed that a meeting took place, with officials of the EDA, Envirodyne, Wisconsin Steel and "other interested parties" present. He called the talks "very preliminary."

Last week, Envirodyne reported a 1979 loss of $44.1 million and said its auditors suggested that Wisconsin Steel, which represents 93% of Envirodyne, mightn't survive. Envirodyne has said it would need "at least $8 million" in assistance to keep the struggling steel subsidiary alive.

The total consolidated debt for Wisconsin Steel at the end of 1979 was $149.5 million, according to Norman Nachman, the bankruptcy attorney for Envirodyne. He said that company officials will meet with officials of Chase Manhattan Bank today "to free up some cash."

Mr. Nachman said he expects "some restructuring" of Wisconsin Steel, and that it might be "a matter of many months" before the question of Wisconsin Steel's viability is resolved.

APPENDIX Y.—MATERIAL ENTERED INTO THE HEARING RECORD BY SEC CHAIRMAN HAROLD M. WILLIAMS: SPEECH BEFORE THE SECURITIES REGULATION INSTITUTE, JANUARY 17, 1980



NEWS

SECURITIES AND
EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

FOR RELEASE: 4:00 PM, EST, THURSDAY, JANUARY 17

TENDER OFFERS AND THE CORPORATE DIRECTOR
An Address by
Harold M. Williams, Chairman
Securities and Exchange Commission

Seventh Annual
Securities Regulation Institute
San Diego, California
January 17, 1980

NOTE: This is the final draft of Chairman Williams' remarks. Although this draft may be quoted, the Chairman might have made minor revisions during this oral presentation. These alterations, if any, will be reflected in the printed text of the speech which will be available from the Commission's Publications Unit in the near future.

In my two prior appearances before you as Chairman of the Securities and Exchange Commission, I shared with you some thoughts about directors' responsibilities, the composition of corporate boards, and the sociology of the boardroom. Today, I intend to shift the focus somewhat and talk about the current acquisition wave -- particularly unfriendly tenders -- and the role of the board of directors confronted, whether as target or offeror, with a takeover proposal. Tender Offers, especially those which do not enjoy incumbent management's support, have become increasingly common during the past several years. Moreover, tender offers, like other facets of corporate conduct, have the potential to become another area in which business and government find themselves pitted against one another. In contests of that nature, government, as the only social institution that can legally enforce its will, must win, if the issue is reduced to one of power. For that reason, I want to suggest to you today what I think the issues are and a framework within which businesses -- whether cast as the targets or the initiators of a takeover -- can respond in a fashion which is consistent with the preservation of the public's trust and confidence in the private sector's ability to engage in decision-making compatible with the welfare of the economy and the society as a whole.

The Dynamics of Corporate Takeovers and Acquisitions

At the outset, I want to explore some of the economic and social facets of the current wave of tender offers and acquisitions -- a phenomenon that can be viewed from two perspectives. The choice of which model to adopt will play a large role in determining how a director responds to a concrete situation.

On the one hand, it can be argued that the possibility of takeover serves as a healthy marketplace check and discipline on management. When the corporation is run in such a way that the earning potential of its assets, resources and market position are not realized, others with more skilled or more imaginative management may seize the opportunity to oust the incumbents. From this viewpoint, the economy as a whole benefits from the takeover process. It is the force which squeezes the most inefficient managers out of the system and replaces them with those who can do better. And, more broadly, takeovers are a means by which successful companies can take advantage of the economies, efficiencies, and synergy which flow from properly selected acquisitions.

The other perspective on takeovers treats them as a kind of unfair opportunity created by quirks in the market's valuation of a company or by overall market conditions. Under this theory, the managers who are ousted are not necessarily less competent than their successors, and the advantages of synergy and improved financial management and financial controls are rarely obtained. The takeover phenomenon is simply the result of a depressed market for the target's shares coupled with the ambitions of the raider's management to build a larger corporate empire.

My own sense is that much of these two models of the takeover phenomenon contains elements of truth, but that different motivations predominate, depending upon the economic climate. In the '50's and '60's, when the securities markets were far more buoyant than they are today, many of the acquisitions which were effected resulted in net gains to the economy measured in terms of the improved condition of the combined companies. I exclude, of course, the financially motivated "Chinese money" conglomeration craze of the late '60's in which the only concern was with a favorable impact on earnings per share. By the same token, however, unfriendly acquisitions were not common. Indeed, the idea of seizing control of a corporation over the objections of incumbent management probably struck most executives as an ungentlemanly tactic best left to a small group of notorious raiders.

The spate of takeovers which we have experienced during the last several years is different in several respects. The first, and perhaps most unsettling, aspect of the current wave of mergers and acquisitions is the legitimacy which hostile tender offers have come to enjoy. It has become acceptable to treat corporations as the sum of their properties and to assume that corporate control may change hands with no greater concern about the consequences than accompanies an exchange of property deeds in a game of Monopoly. But, a corporation is more than the aggregate of its tangible assets --and more than the equity of its current shareholders -- it is an institution with a complex of interpersonal and contractual relationships that create legitimate interests in the corporation among employees, suppliers, customers, communities, and the economy at large.

As I suggested a moment ago, this new crop of corporate takeovers has been fueled -- if not caused -- by low stock market prices. At the present time, I would estimate that at least one-third of New York Stock Exchange listed companies are selling below their book value. And, in a period of low stock prices and high inflation, managers may see considerable attraction in buying out other corporations or their assets at below their current value in the hope of repaying the resulting debt in depreciated dollars. Such a strategy may seem far less risky than the alternative of capital spending for plant and equipment, particularly because the increasing cost of building new facilities today seems so frequently to outpace the inflation rate. This type of reasoning, coupled with a regulatory framework that often seems designed to create obstacles to new projects or products, serves to encourage the search for takeover targets rather than for capital spending, product development and innovation opportunities.

In short, it is not surprising that, as a competitive response, corporate takeovers often are viewed as a better alternative than investing resources in the existing businesses of the corporation. The immediate results of a takeover are particularly attractive to a corporate executive who seeks the ego satisfaction, prestige, and remuneration associated with size and the appearance of of growth. In contrast, the impact of investment spending on earnings, and the deferred nature of its rewards, may not seem to be of benefit to current managers or fit with their short-term time horizon in office.

In this regard, a recent book by an experienced business consultant makes the point that the compulsion for growth -- especially in conglomerates and in companies where financial objectives are the main criteria for executive advancement -- has been generally damaging to the development of sound business and sound business managers. He concludes, in part, that "[g]rowth strategies and totalitarian managment may actually be significant factors in creating inflation and economic instability." */ In a similar vein, Henry Simons, the late University of Chicago economist, observed that such consolidations can be explained in terms of "promoter profits," that is, the personal ambitions of corporate "Napoleons" and the psychological rewards which they derive from power.

What are the consequences of this type of activity? What public policy isues are raised? Inherent in the overall acqusition wave, exaggerated by the increasing use of hostile tender offers, is a concern about the concentration of this nation's economic power, as well as the appropriate use of corporate resources in a period of increasing international competition and shrinking U.S. domination -- when the United States has the highest percentage of obsolete plants, and the lowest percentage of capital investment, growth in productivity and in savings of any major industrialized society. In the last five years, I would estimate that $100 billion of corporate cash resources -- resources which could have been devoted to new production and employment opportunities -- have been diverted to rearranging the ownership of existing corporate assets through tenders alone. These are

---

*/ R. Wild, Management by Compulsion: The Corporate Urge to Grow (1979).

resources that do not flow back as new capacity, improvements in productivity, innovation, new products or new jobs. Rather, particularly because of the dearth of new equity offerings in recent years, at best these dollars remain in the secondary market.

The long-term effect of this type of financial inbreeding is likely to be very troublesome. Resources that should be used to increase this nation's productivity and to generate new products are diverted to create a carousel in which management is replaced by new management which, in turn, may also be replaced. Moreover, businessmen are spending increasing attention and energy looking for companies to acquire -- and in avoiding being themselves acquired. Sometimes this process results in better, more innovative management; but, too often, it does not.

Viewing this phenomenon, it is, of course, important to bear in mind that a society which places as much reliance as does ours on government as an instrument to check the perceived excesses of business is unlikely to tolerate indefinitely business behavior which the public regards as contrary to its interests. I mentioned a moment ago that hostile takeovers may have serious impact on groups -- such as corporate employees -- outside the world of finance. Similarly, it is not surprising to see some very legitimate questions being raised about the economic and social justifications and implications of the current takeover wave. The concerns which seem presently to be the most prominent are those which fit under the rubric of competition, but deal with power and market domination, and are reflected in the efforts of the Attorney General, the Federal Trade Commission, and various Congressional leaders to put new teeth into antitrust and anti-merger legislation. Indeed these efforts, which do not, in my judgment, focus on the most significant economic consequences of acquisitions and takeovers, may be the most serious challenge to corporate latitude in structuring business combinations since the initial enactment of the Sherman Act almost 100 years ago. Of course, the basic thrust of the acquisition wave should focus not on how to put a lid on it but on the governmental policies -- monetary, fiscal, tax, and regulatory -- which encourage it and discourage the willingness to risk, venture and innovate as well as on those impairments of the market place where the forces of competition are not able to function effectively.

While I have expressed skepticism about the consequences of some contemporary takeovers, I am not enthusiastic about legislation which would prohibit certain categories of mergers. Legislation, which responds to a wave of mergers and takeovers motivated primarily by a combination of a depressed stock market and regulatory obstacles to other forms of corporate growth, would be just as effective in preventing the consummation of acquisitions which would have real economic and social benefits in terms of efficiency and synergy as it would be in frustrating less rational consolidations.

Role of the Board

For these reasons, I believe the central issue in developing an approach to takeovers is to assure a private sector vehicle which will evaluate acquisitions in terms of the full range of relevant factors -- such as whether they make substantive economic sense and deal appropriately with those groups to which the corporation as an institution has responsibilities. In my view, the independent director is the only actor on the corporate scene equipped to play this role. Unfortunately, however, at professional gatherings, such as this Institute, most discussions of tender offers seem to center on the techniques and mechanics of a takeover contest -- that is, the various devices for complying with, or avoiding the application of, the federal securities laws and the state anti-takeover requirements. Conversely, there typically is inadequate reflection on the legal and ethical standards that should govern the directors' discharge of their role in these transactions. While the subject is a broader one than I can fully cover in the course of one talk, I want to spend the balance of my time with you today presenting a framework which can, I believe, serve as a foundation for the director -- whether of the would-be acquiror or the target -- who is involved with a takeover.

As I indicated earlier, conventional thinking concerning the corporate response to the threat of a takeover seems to spring from one or the other of two rather simplistic theories. One theory is that the market-place should enjoy unhampered control over the fate of these transactions. That is, the shareholders at that point of time, the presumed owners of the company and beneficiaries of its endeavors, should have the absolute right to determine whether or not to accept the tender. As a corollary, it is assumed that shareholders will make this decision based solely on an appraisal of the economics of the problem -- is the bidder's proposal sufficiently attractive to justify takng the proffered cash, incurring any tax liability, and reinvesting in a new opportunity? This theory, of course, effectively means that an offer carrying a substantial premium over market value will -- and should -- always succeed.

The opposing theory, advanced quite naturally by those who see themselves as managers rather than shareholders, emphasizes that a corporation's response to a tender offer should come from its directors, who are expected to bring their knowledge and expertise to bear in representing the corporation as a unique entity rather than simply seeking the best deal for its individual shareholders. In discharging this responsibility, directors generally are protected by the business judgment rule from all but the most extreme deviations from what particular shareholders might view as their interest. This theory's corollary is that directors, if they decide that a takeover is not in the best interests of a corporation, may resort to virtually any weapon in the legal arsenal to defeat it. Indeed, the courts have seldom rejected a director's invocation of the business judgment rule to shield himself from a shareholder's suit concerning resistance to a tender offer.

In my view, neither of these theories is useful in illuminating the responsibilities of the directors of the parties in a contemporary tender offer situation. The notion that a corporate takeover should stand or fall solely on the market-place's determination of the sufficiency of an offeror's premium is particularly unsatisfying. For one thing, true, from the bidder's standpoint it ensures that almost every tender offer -- or at least the highest competing tender offer -- will succeed. From the target's standpoint, it makes the directors' task simple and avoids litigation. But more fundamentally, this theory precludes other than a market value assessment of the corporation, ignores its responsibiities as an institution and assumes the society would overlook economic decisions which could substantially affect its welfare. This is simply unrealistic.

Emphasis on market-place acceptability also fails to come to grips with the legal responsibilities which characterize the corporate form of business. For example, is it a complete answer to the duties which managers and directors owe to shareholders to assume that an above-market tender offer is in the shareholders' best interests? One wonders, as a matter of fundamental fairness, whether the interests of speculators and arbitrageurs, who move in and out of large positions with little regard to the strengths and weaknesses of the underlying enterprise, should be the decisive factor in determining a corporation's future. I am not advocating a holding period requirement for the exercise of the corporate franchise, but neither do I want to see the interests of the long-term shareholder, who behaves as a corporate owner -- or of shareholders over time -- subordinated to the interests of speculators, who see profits in betting against the corporation. Although I recognize the essential value of market-place discipline as a prophylactic against poor management, the benefits of that discipline are lost if management must behave as if the corporation is continuously on the block.

For these reasons, the vehicle for balancing the competing concerns which must be weighed in evaluating a tender offer is to be found not in the marketplace but in the corporate boardroom. Directors should make the decision, as they do all other corporate policy decisions, and do so based on an assessment of the corporation as an institution with responsibilities to discharge, rather than simply seeking the best deal for their shareholders. I do not mean, however, that directors should be free to resort to protective measures and then ritualistically invoke the protection of the business judgment rule. Judges are, naturally, not comfortable second-guessing directors in complex and delicate areas, such as takeovers, particularly when they may suspect that the judicial process is being used as a bargaining chip in a larger game. Nonetheless, in my opinion, the courts -- in recognizing the significance of takeovers to the economy and to groups of individuals to which the corporation has responsibilities -- are beginning to inquire whether, in making such a business judgment, a board of directors has met certain minimum, but increasing, standards to warrant judicial deference. Those standards relate to the competence of the decision-maker -- the directors' objectivity and the processes used to arrive at their judgment. The touchstone is whether proper inquiries were made by unbiased and knowledgeable individuals and whether the results of that process were conscientiously considered and applied.

The Bidder

I want now to explore what this concept means in practice to both the board of the bidding corporation and that of the target.

Most of the scanty literature regarding a board of directors' role in assessing tender offers is directed exclusively at the role of target's board in evaluating the offer. The apparent indifference to the role of a potential bidder's board in determining whether to proceed with an acquisition or tender offer is difficult to interpret. Certainly, one should not overlook the responsibility of the board of directors for the direction of the corporation in a transaction which may be as crucial to the bidding corporation's future as it is to the target company's. At a minimum, the board of directors must be assured that an acquisition is in the best interests of the corporation and its shareholders, and that reasonable procedures have been established to assure the transaction's compliance with applicable laws and regulations.

Directors, and particularly independent directors, must play a major role in evaluating the appropriateness of a proposed acquisition. Without implying a lack of confidence in management, the independent directors must be sensitive to the possibility that management's judgment may be skewed in a particular case. As I noted earlier, there is an unfortunate tendency on the part of some to assume that bigger is somehow better. Therefore, to a large extent, it is the independent directors' responsibility to satisfy themselves that such an acquisition makes substantive long-term good sense for the company. They should not merely accept undocumented rhetoric about synergy or the benefits of improved management or financial controls, which may tend to be more illusory than real. The directors should consider management's prior experiences and track record or its lack of them in assessing and acquiring target companies, integrating new acquisitions into the corporation, and delivering the anticipated benefits.

In order to fully discharge their responsibilities in considering the offering price, directors should make a determination, based on articulated standards, of the cash worth of a potential acquisition target. The justification for a premium should be considered specifically. Additionally, in the case of a hostile tender offer in which the bidder does not have access to much critical information about the target, directors should also consider whether it has a sufficient basis for determining the value of the target company and whether that company can be successfully integrated into the acquiring corporation. In this regard, I should note that the large premiums that have been paid in certain recent acquisitions make one wonder how carefully the bidding corporation's board considered the econonic justification for the transaction. Particularly, where premiums of as much as 100% over the pre-tender price are offered, the burden of determining that such a premium is indeed justified is not a lightly or easily discharged one.

Moreover, in making such a determination, the board of directors has a responsibility also to consider the available alternatives and whether any such alternative would be more in its own shareholders' interests. For example, boards should not ignore that diversification often results in a lower share price and multiple. An alternative course for the company with excess cash might very well be to consider distributing the cash to its own shareholders, rather than to shareholders of a target company. Until the 1970's, I personally was opposed to a company's buying its own stock. I viewed it as a reflection on management's ability to invest intelligently in building the company, as contrasted to liquidating it, while creating the illusion of growth through an increase in earnings per share brought about by spreading earnings over fewer shares. However, I now believe that this may be an appropriate alternative if a company cannot otherwise absorb the cash in its own business. Such a corporation can give its own shareholders the benefit of the premium to do their own diversifying by reinvesting this distribution -- possibly even in the same target company -- at the market price rather than at a premium.

Having decided to proceed with an offer, it is the board's responsibility to ascertain that procedures have been established to ensure compliance with laws and regulations which prohibit the misuse of non-public information concerning a potential acquisition or tender offer. In addition to being a violation of the law, I believe that the misuse of such non-public information contributes significantly to a loss of investors' confidence in the fairness of the marketplace.

The Commission is addressing this problem through both enforcement actions and rulemaking. But boards of directors of bidders -- as well as other parties such as investment bankers -- have the responsibility not only to ensure that procedures are in place to prevent leaks, but also to examine and monitor these procedures and take stringent actions when violations of the procedures are uncovered.

Subject Company

Much more has been written and discussed about the board's role when its corporation is the object of an acquisition proposal or a tender offer. As I already indicated, It is my opinion that an effective board of directors remains the institution best suited to weigh the oft-conflicting factors that may influence a corporate response to such a situation.

However, I also must emphasize my belief that this role for the board also involves special responsibilities for competence and objectivity. I do not believe that the judicial deference incorporated into the business judgment rule should apply in a takeover situation, absent the boards' establishing that they have, in fact, satisfied these responsibilities. Therefore, I believe that a board's actions in response to a tender offer should increasingly focus on two important questions.

The first question regards the credentials of the decision-makers. The most important credentials, of course, are competence and objectivity. Obviously, a management director -- whose very livelihood may be affected by the board's decision -- cannot be presumed to be acting solely in the corporation's and shareholders' interests. Nor can other directors who have a substantial economic interest in the continued separate existence of the corporation, including as suppliers of its goods or services, be necessarily considered objective in these deliberations.

Thus, to satisfy such an inquiry, I would expect to find an increasing number of instances in which a corporation's board delegates to a special committee of independent directors the investigation of an offer and the recommendation to the full board of an appropriate response. This is not to say that management directors and others with economic interests in the outcome should abstain from participating in the board's ultimate decision; but, if they provide the margin in rejecting the tender, they may have a difficult burden in establishing that they, in fact, acted objectively in the corporate and shareholder interest. (Parenthetically, I should add that, when there are conflicting interests between an acquiring corporation's management and its shareholders, the logic of that corporation's forming a special committee of independent directors to monitor the terms of the transaction and its management's conduct would seem equally applicable.)

The second question regards the substance of the process to be followed by the board in determining whether the offer is in the best interests of the corporation and its shareholders. In view of limitations in time, this subject, which is being increasingly addressed in the literature and otherwise, is one I will only touch on with several observations.

In addition to analyzing the offer's terms, the board, as I already noted, has an institutional responsibility to consider such concerns as: the potential adverse impact on employees, suppliers, and communities; any likely anti-trust limitations; whether the offer is for less than all outstanding securities, which raises the spector of a residual minority which may be locked into their investments; and any likely discontinuation of unique goods or services to the public. The key, however, is the substance as contrasted to the window dressing and the rhetoric used to dress-up on otherwise unjustified defense.

Assuming a decision to resist, the board must recognize that conflicts may exist when acquisition or tender offers are presented. Therefore, the committee's responsibilities would not be satisfied, absent the committee's continuing examination of management's conduct during the encounter, including its public pronouncements, its communications with any actual or potential bidder, and its representations to the courts -- and the regulatory agencies. This is an on-going function not satisfied by a single meeting -- even the increasingly lengthy meetings which oftentimes represents the board's sole consideration of an offer before issuing a response.

A few moments ago, I suggested that as part of its consideration of an offer, the offeree's special committee should not limit its analysis to an examination of the offering price -- that it should also consider other factors which potentially could influence the continuing viability of the target corporation or its relationship to certain groups to which it has responsibilities. What should constitute the kind of consideration of these subjects that would warrant judicial or administrative deference?

First, I do not believe that receiving a statement from one's investment banker -- particularly a "quickie" to the effect that an above-market offer nonetheless is inadequate in relation to the true value of the target -- is, in itself, sufficient to satisfy the special committee's responsibilities. At the very least, it should independently verify and accept the factual assumptions upon which the investment banker's valuation is grounded.

Moreover, the basis for any assertion about the corporation's intrinsic worth and future growth prospects should also be examined carefully by the committee. Of course, any documentation which is composed after the bid, particularly if not consistent with current performance, would be somewhat suspect. Rather, prudence would rely more confidently on bona fide corporate planning documents prepared and considered in normal course and prior to the initiation of any offer. Further, any claim of adverse impact on employees, suppliers, customers or the public should be similarly documented.

It is my view that a court -- in reviewing such a well-monitored, fully-considered and documented special committee determination to reject and resist an acquisition or tender offer bid -- should and would give substantial deference to that decision and to any legal and ethical acts to resist the bid which are reasonably commensurate to the existing threat to the corporation's and its shareholders' interests, provided that the acts themselves are not inconsistent with the corporation's viability. But, I emphasize that does not give the corporation the right to waste corporate assets, by for example, an otherwise senseless acquisition, or to make vacuous charges against the opposition or engage in other unethical conduct.

While encouraging the board to consider the impact of a takeover on groups to whom the corporation has responsibilities, I do not endorse anti-takeover provisions of this or any other sort, by charter or by-law designed to make the company a less attractive target. Although I recognize the desirability for management to be able to run its company without continually looking over its shoulder, I believe that tenders should be considered on their merits, on a case-by-case basis, and not warded-off by building castles and moats.

indeed, the corporate community cannot have it both ways. It cannot argue against added measures -- legislative or otherwise -- directed to improve corporate accountability by relying on the discipline of the marketplace as a vehicle to depose inadequate management, and then seek to neutralize that discipline by anti-takeover provisions. By doing so, it is inviting a legislative reaction.

The Commission's involvement with such amendments heretofore has involved only the issue of appropriate disclosure, and the legitimacy of such amendments has, thus far, remained a matter of state law. I was, therefore, particularly interested in a recent Delaware decision in which the Chancellor approved an anti-takeover amendment that requires an 80 percent shareholder vote to approve a merger, consolidation or similar takeover by any person owning five percent or more of the company's stock prior to the proposed takeover. 3/ Notably, the amendment also provides that the super-majority provision will not apply if the company's board of directors approves the proposed transaction before acquisition of the five percent interest. In other words, the board has the power to lower the barrier for a friendly acquisition. Whether such apparent flexibility

---

3/ *Seibert v. Gulton Industries, Inc.*, Del. Ct. of Chancery, Div. Action No. 5631, Memorandum Decision of Vice Chancellor Brown (June 21, 1979); notice of appeal of Del. Sup. Ct. filed Aug. 8, 1979.

will result in abuses -- such as its use as a bargaining chip to enhance incumbent management's interests at the expense of shareholders -- will be a subject of continuing concern.

The possibility for such abuses that may be associated with such defensive corporate charter and by-law amendments may well lead to legislation. As I have stressed on many previous occasions, I am not in favor of federal legislation which would dictate corporate structure. Nevertheless, legislation dealing with anti-takeover amendments could very well receive a more welcome reception at the Commission and in Congress. And, while limited to a specific problem, such legislation would be a big step toward federal corporation law.

This is not to ignore the need for management to be able to run a company without continually looking over its shoulder and engaging in defensive activities. Good managements of well-run companies should not have to spend abnormal amounts of time looking at transfer sheets, talking to lawyers and engaging in anti-takeover activities. But, defensive charter or by-law amendments will not be a viable solution in the long-run.

I also recognize that a tender offer for the stock of a company creates a most difficult period for a company's management and its board of directors. Management is perceived as being concerned only with keeping their jobs, and the board of directors is caught between their duty to shareholders and their responsibility to the corporation as a whole and its future as a business enterprise.

But, except for the unusual time constraints, decisions regarding tender offers should be treated no differently by the board than other major corporate decisions. On one hand, it should realize that defensive tactics of incumbent management may be clouded with self-interest and should be subject to the same close scrutiny as other situations involving that dynamic. On the other hand, decisions of independent directors based on an appropriate analysis of an offer should receive the same deference as it would in similar decision-making.

Conclusion

In conclusion, let me return to the principle to which I have referred in a number of my talks across the nation: Under the American system, anyone who exercises power needs to be held accountable to someone else for his stewardship. Acquisitions and tender offers are perceived correctly to involve the exercise of considerable power -- that is, the ability to influence many persons' lives and futures. Jobs, the welfare of entire communities, and, indeed, the national economy undoubtedly will be affected by these transactions.

This nation cannot -- and will not -- allow matters of such vital significance to be unaccountable to rational decision-makers who are acting according to publicly acceptable norms.

Today, I have strongly advocated that this decision-making role for tender offers be filled by vigorious boards of directors composed of persons of independent credentials who effectively meet their responsibilities along the lines which I have discussed here with you. I hope that this analysis generates a discussion among those in business, the government, the bar, and academia to evaluate the inplications of the current acquisition and takeover wave on the future of the free enterprise system. And, I also hope that this discussion will influence the corporate community in determining that restraint may be a very appropriate business decision.

Thank you.

Appendix Z.—Material Submitted by SEC Chairman Harold M. Williams

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

03 APR 1980

The Honorable Berkley W. Bedell
Chairman
Subcommittee on Antitrust and Restraint
  of Trade Affecting Small Business
Committee on Small Business
House of Representatives
Washington, D. C. 20515

Dear Chairman Bedell:

During my appearance before the Subcommittee on February 27, you asked me to submit for the record my thoughts concerning possible changes in tax policy to encourage increased private sector productivity. While the SEC has, of course, no jurisdictional mandate with respect to these matters, I have been personally interested for several years in this subject, which is vitally important to our Nation's economic future. Therefore, I have spoken, in an individual capacity, on the problems of capital formation on a number of occasions since becoming the Commission's Chairman.

In an address to the Economic Club of Chicago, which is enclosed for your information, I discussed my view in this area and suggested some specific proposals to amend the tax code. The address reflects my belief that tax policies intended to stimulate economic development should focus exclusively on improving long-term productivity. Ideally, these tax laws should reflect two goals. First, the tax code must offer meaningful incentives to business to invest in equipment and facilities. Additionally, in my judgment, the tax laws must allow reasonable rewards to investors -- particularly individuals -- who commit capital to productive ventures generally, and small and start-up companies particularly. On the other hand, I am not confident that the national tax policy necessary to encourage capital formation can be realized if Congress continually tinkers with crucial investor incentives in response to short-term economic conditions.

In this regard, I believe that the current accelerated depreciation applicable to business should be liberalized in response to the Nation's critical need to expand and modernize productive capacity. These changes would have a direct impact on the rate of return to corporations investing in a new productive capacity, which, in turn, is likely to be translated quickly into greater investment activities.

Moreover, with respect to individual investors, tax policy should focus on incentives to contribute capital to the productive sectors of the economy. Accordingly, in 1978, I testified before the Senate Finance Committee in support of S. 3065, a bill to restore capital gains taxation to the rates which had prevailed prior to 1970. I have enclosed a copy of my statement to that Committee, which also discusses my concerns regarding capital formation.

I recognize that particularly acute problems apply to the capital formation efforts of the small business community. Therefore, I suggest that Congress consider special investment incentives to encourage the capitalization of small and start-up ventures, which typically provide important innovations and other societal benefits. One such possibility might be an investment roll-over provision which would permit investors to avoid recognition of certain gains realized from investments in "qualifying" small businesses. In order to make such an exemption manageable and direct its focus to small and medium-sized investors, such a provision might, for example, provide a maximum exemption from taxation of $5,000 per year to a taxpayer with a lifetime ceiling of $100,000.

I hope that the foregoing thoughts will be helpful to the Subcommittee. Please let me know if I can be of any further assistance.

Sincerely,

Harold M. Williams
Chairman

Enclosures

NEWS
SECURITIES AND
EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

FOR RELEASE: 8 P.M., February 23, 1978

ECONOMIC PRIORITIES FOR BUSINESS

An Address By
Harold M. Williams, Chairman

The Economic Club of Chicago
Chicago, Illinois
February 23, 1978

I studied with considerable interest the findings of a recent survey entitled "How Americans Judge Basic Institutions" reported in the February 13 issue of U.S. News and World Report. The poll examines how a sampling of individuals rate some of our national institutions, including business and professional groups and their leaders. My own interest in the survey sprang, not merely from the results, but from the perverse way in which those results track the direction of my own career, a career which has progressed -- and I use that word advisedly -- from lawyer to business executive to educator to regulator. Those questioned were asked to rank the various institutions on a scale of 1 to 7, and, based on the numerical average of the responses, the editors classified the institutions as "relatively good," "medium," or "relatively poor" in terms of the public's perception of their ability to get things done.

The respondents rated large business as "relatively good" with an average rating of 4.47 and business executives -- the field in which I spent the largest share of my working career -- as "relatively good" with a rating of 4.43. The legal profession, another earlier phase of my career, came in at "medium" with a 3.99 average rating. Educators, the group to which I belonged when I was Dean of the Graduate School of Management at UCLA, also earned a "medium" rating, but with a lower average of 3.84. The Democratic Party was rated as "relatively poor" at 3.29, and my present affiliation, "regulatory agencies," was similarly perceived as "relatively poor" with an even lower average rating of 3.20. Finally, the Republican Party at 3.10 and politicians at a dismal 2.69 closed out the field. Since I have no interest in becoming a politician, it seems that the only course open to me in order to continue the inexorably downward trend in my career is to move over to the Republican Party.

I interpret this data, and other similar studies, to reflect a sense that, in terms of effectiveness in discharging what is perceived as its primary mission, business is generally more effective at delivering goods and services than regulators generally are at regulating. I would have to agree. And while regulators work at doing better -- and perhaps even at doing less and doing it better -- I am concerned that business not impair its ability to do its job at least as well as it has.

For that reason, I am especially pleased to speak this evening on economic priorities for business -- and particularly on inflation. The subject is an important one; in fact, inflation is the most serious economic problem facing our country. I would like to trace briefly the consequences which flow from the gap inflation opens between conventional measures of corporate financial performance and economic reality, and to sketch the outlines of some of the responses to that gap which I believe to be worthy of your consideration.

The Problem: Inflation and Economic Realty

Corporate earnings are regarded as the most basic numerical measure of corporate performance and business success, and, in the aggregate, of the success of the business sector as a whole. Investment decisions, executive promotions, public attitudes toward business, tax policy, the implementation of social programs, and a host of other judgments rest largely on the number which appears on "the bottom line."

Because, I suppose, of the precision which numbers imply, it is easy to lose sight of the fact that corporate profits, like any measurements, are no more reliable than the assumptions on which they rest. Financial reporting depends on a wide variety of assumptions and conventions -- the use of historical costs, the various methods of depreciation, the criteria for distinguishing between capital expenditures and expenses, and many others. While I am not disputing the logic of those principles, in my view, the resulting corporate earnings figures should never have been treated as precise; business earnings would more meaningfully be reported or interpreted as a range rather than a single figure -- exact down to the penny when reported in the form of earnings per share.

In any event, whatever the significance of corporate profit figures in an inflation-free economy, the impact of inflation has compelled a re-examination of the meaning of the portrait of corporate earnings which traditional financial reporting paints. Increasingly, we are becoming aware that the consequences of reliance exclusively on a measure which distorts the economic contours of business performance are felt throughout the economy -- from the overall capital formation process to the day-to-day managerial decisionmaking in each firm. More broadly, if our ability to judge and report the economic performance of business is skewed, then both the public and its elected representatives are unable accurately to analyze the contribution which business is making to our society.

During the past 10 or 15 years, the public has come to demand more and more that business discharge obligations which might, in some sense, be thought of as social rather than purely economic -- the protection of the air, water, and the other facets of the natural environment; the promotion of occupational safety; the implementation of the national policy of equality of employment opportunity; and similar objectives might fall in this category. In the long run, of course, it may be difficult or impossible to separate the economic components of each from the social components. In any event, these new factors are now as real a part of the equation of business responsibiliity as are the more traditional goals of providing employment and a source of livelihood for our workforce and of producing the goods and services necessary to satisfy a rising level of expectations with respect to the standard of living.

Thus, as a society, we are placing increased demands on our private enterprise system. The problem of marshalling sufficient capital in order that business may discharge its role in accomplishing these goals is a serious one. Unfortunately, however, the effects of inflation upon the present methods of reporting business performance obscure the increasingly pressing need to bring forth additional capital and, indeed, may lull us -- as government policymakers, as decision-makers in private business, and as individual citizens -- into a belief that corporations are generating more than adequate funds to satisfy our long-term demands for capital.

The public perception seems increasingly to be that American business profits -- particularly those of the largest firms, those most able and most responsible for aiding in accomplishing our national objectives -- are huge and growing larger. This misimpression leads inevitably to demands that the government take steps -- often through tax policy -- to moderate those profits and to divert them to the commonweal, either directly through the funding of federally-mandated programs of social value, such as OSHA, or indirectly through what we have come to call transfer payments whereby corporate taxes are reallocated to social purposes.

In my judgment, American corporations, as a whole, rather than generating shockingly high profits, are earning at dangerously low levels relative to their long-term reinvestment needs if they are to discharge the responsibilities we expect them to shoulder. Profit trends -- especially as they affect cash flow available to replenish, modernize, and expand assets and to pay dividends -- are probably the most important factors in evaluating common stocks in the marketplace. Despite their importance, however, I believe that the function and level of corporate earnings and corporate ability to generate the cash needed to replace and expand productive capacity over time are seriously misunderstood today -- in large measure because of the hidden impact of inflation.

It is commonplace to read in the press that particular well-known corporations have reported "record" or "all-time high" earnings. In terms of the absolute number of dollars involved, these statements are, of course, true. It is, however, useful and important to put those figures in perspective. And when the perspective is comparative earnings over time, their "real" value, and the ability of business to generate required new capital, then what are reported as "record" earnings may prove to be disappointingly low.

How can corporate profits be low in any sense when reported after-tax earnings of non-financial enterprises hit a record of $77 billion in 1976 and, according to estimates, went even higher in 1977? One striking element is the consistent, substantial understatement of depreciation in an inflationary environment. This is, however, by no means the only way in which accounting based on historical costs distorts corporate profits. Valuation methods which do not exclude inflation-generated inventory profits also overstate income. Both of these problems erode the value of reported earnings while adding to taxable income and thus generating tax liabilities which may, in fact, have to be paid partly out of capital. As long as reported earnings continue to fail to take into account an accurate assessment of the economic costs of using and replacing the assets, both current and fixed, which produce those earnings, investors, managers, government policymakers, and the general public will all necessarily remain uncertain, confused, and misled as to the level, expected growth, and rate of change of profit.

Studies have shown that, if depreciation were recomputed based on the current-cost, double-declining balance method in order to charge against revenues a sum which more accurately reflected both the manner in which capital equipment was consumed and the cost, in inflated, current dollars of replacing it, and if inventory consumption charges, as reflected in the cost of goods sold, were reconverted from historical to current costs, 1976 after-tax profits of non-financial corporations would shrink to some $43 billion -- only a little more than half the $77 billion figure reported. In effect, corporations reported as profit $34 billion required to offset or restore capital consumption. By comparison, in 1966, the year in which the market peaked, reported after-tax earnings were $40 billion -- about half of the 1976 reported figure of $77 billion -- while inflation-adjusted profits in 1976 were $39 billion -- only 10 percent below after-tax earnings a decade later.

If we direct our attention to the share of its profits which business retains after dividends as a source of capital for reinvestment, studies indicate that annual retained earnings, adjusted as described above and converted to constant 1972 dollars, fell from $28 billion in 1966 to $7.9 billion in 1976 -- a drop of around 70 percent -- and produced a $13.3 billion deficit, after dividends for 1974 alone. While there were net additions to adjusted retained earnings in 1975 and 1976, those additions were insufficient to offset the 1974 deficit. Thus, over the most recent three-year period for which final figures are available -- 1974 to 1976 -- business has, in effect, apparently paid dividends out of capital.

The effect of this effort to adjust corporate earnings for inflation is even more startling from the perspective of federal tax policy. During the past 11 years, the effective tax rate on reported corporate tax basis earnings has generally hovered around 42 percent. However, if actual tax liability is compared to pre-tax profits adjusted for inflation-based underdepreciation and inventory gains, a much different picture emerges: In 1966, the effective rate on adjusted earnings was quite close to the 42 percent rate on reported income. In 1976, the effective tax was 56 percent, while in 1974 it was an amazing 80 percent. Not only are we reporting the consumption of capital as income, but we are paying taxes on it. Inflation, and the failure of the tax system to recognize its distortions, have increased the real rate of corporate taxation substantially without congressional action and without the debate that would occur if such a tax increase were formally proposed.

If we are to meet our need for adequate new investment, the disclosure and taxation systems must be converted into tools which will aid the effort rather than obstacles which frustrate it.

The Impact on Capital Formation

In 1976, the Department of Commerce prepared one of the most detailed and comprehensive discussions of investment requirements ever undertaken. Its findings are generally consistent with other studies. In its "Study of Fixed Capital Requirements of the U.S. Business Economy, 1971 to 1980," the Department's Bureau of Economic Analysis looked at capital needs on an industry-by-industry basis. The purpose of this study was to estimate the amount of investment necessary, through 1980, in order to have an economy capable of meeting three objectives -- reasonably full employment, a national program of environmental protection, and decreased dependence on potentially unstable foreign energy resources. The Bureau found that real capital investment -- that is, nonresidential, fixed investment -- must average about 11.4 percent of gross national product. Capital spending has, however, not led the economic recovery, averaging less than 10 percent for the recovery period. In fact, the Department predicted recently that the rate of real capital spending during 1977 would be only 8 percent and would be lower still in 1978, running at half the figure which the Administration had targeted as necessary to reduce unemployment.

The Department's 1976 study also contains interesting findings with respect to the uses to which new investment would be put. It found that the majority of the projected national investment needs during the period analyzed would be employed simply to keep us from slipping below present productive capacity. This finding is a reflection of our chronically low rate of capital formation in the last decade.

And to the extnet that investment is insufficient, society will pay the price in terms of fewer jobs, a generally lower standard of living, and -- perhaps most importantly -- a perception that our economic system is not capable of satisfying our needs. Reginald H. Jones, the Chairman and Chief Executive Officer of General Electric, has translated this concept into an analogy which, I think, aptly illustrates the problem. He notes that one of the watershed developments in human history was the concept of plant husbandry -- that, by saving some of the seeds produced by this year's crop for next year's planting, the continuation and indeed the increasing prosperity of society could be achieved. He then observes:

> "The same thing applies to industrial societies and business firms. Every year, some part of the total output -- some seed corn -- has to be saved and reinvested in the replacement, modernization and expansion of the industrial machine. This is the process of capital formation. And nations that neglect their capital formation find themselves susceptible to scarcity, inflation, unemployment, and declining standards of living.
>
> In recent years, the United States has been eating into its industrial seed corn."

The Impact On Corporate Decisionmaking

Financial reporting which ignores the impact of inflation also has important implications in business decisionmaking. The most obvious area in which this occurs is in the process of estimating capital needs, the internally-generated capital available, and the projected returns from proposed investments.

Further, disregard for the impact of inflation on the adequacy of earnings distorts pricing decisions. If corporate profits are insufficient to generate the capital necessary to maintain existing capacity, a part of the reason may be that the goods and services which the firm sells are priced unrealistically relative to their true costs of production. It may be difficult for one business to correct underpricing if its competitors choose to ignore the problem, and, in some industries, foreign competition would make correction impossible. Eventually, of course, both those who recognize that they are eroding their capital and those who do not will have to come to grips with the truth. Thus, financial reporting which obscures or ignores the impact of inflation impedes efforts to identify and deal with emerging problems until they become crises.

Finally, there undoubtedly are managers who are being compensated and promoted in return for showing increases in the reported earnings of their operations when, in reality, they are dissipating its capital.

The Impact on Public Confidence in Business

If the validity of the general type of analysis I have outlined is accepted -- or, at minimum, if it is accepted that the net effect of financial reporting premised on a stable level of prices is to buoy profits unrealistically upward when the environment becomes inflationary -- it seems clear that we are caught in a dilemma. Much of the public perception -- encouraged by traditional methods of financial reporting -- is that business profits are already too large -- even obscene -- and still growing. At the same time, the economic reality is that American business overall is not generating and retaining funds adequate even to replace existing capacity and continue operations at present levels. Indeed, some businesses may actually be distributing their capital and be in the process of liquidation.

It is difficult to overstate the importance of a better public grasp of the size, in real terms, of corporate income. Constant reports of "record" corporate earnings, while at the same time business is pleading the case for tax and other incentives to stimulate capital spending, aggrevate the credibility gap which already exists. The net result is both a decline in the credibility of business, based on those inordinate business profits as reported, and government action -- or inaction -- which is not consistent with enhancing the effectiveness of our economic system. Aggravation of the public's confusion concerning profits -- and the manifestations of that confusion in governmental responses -- is perhaps the most serious consequence of financial reporting which fails to acknowledge that the unit of measurement -- the dollar -- is not constant.

Steps To Solution

I would like now to outline some steps which, in my judgment, would contribute to solving the problems I have described. Although I recognize the costs and difficulties in changing corporate reporting procedures and in persuading Congress to alter the tax laws, I believe that more realistic accounting and tax practices could be an important step toward educating the public, their elected officials, and other policymakers to the impact of inflation, to the dimensions of the problem of capital formation, and to the direction in which policy must move in order to deal successfully with the problem.

First, I believe that inflation accounting -- as a supplement to, not a substitute for, historical cost accounting -- must become a permanent feature of financial reporting. In my judgment, the need for disclosure of the impact of inflation on corporate performance is simply no longer open to serious debate. The question is not whether it should be disclosed, but how.

As I imagine many in this room are well-aware, in 1976 the Commission adopted Accounting Series Release No.

190 requiring major companies to disclose the impact of inflation on inventories, productive capacity, and cost of sales. I recognize that many corporate managers have greeted the opportunity which ASR 190 affords them to provide a perspective on reported earnings with something less than enthusiasm. As I have tried, however, to point out this evening, financial reporting must aid investors, business managers, politicians, and the general public in realistically evaluating the performance and capabilities of private enterprise. This is not a theoretical or abstract problem. It impacts directly on the capital formation process and on society's attitudes toward the effectiveness of the private enterprise system.

My purpose tonight is not to defend the methodology of the Commission's current replacement cost rules. In fact, the Commission recently issued a release requesting comments on any problems which companies have encountered in providing replacement cost data pursuant to ASR 190. However, although I am mindful of the expense which developing replacement cost data has entailed, this area is, I believe, one in which the cost of compliance with government regulation will prove to be far outweighed by the benefits. Accordingly, I hope that ASR 190 will not be written off as another example of bureaucracy in action, but rather that the industry will work with the Commission by submitting its best thinking and insights on how the users of financial information can be given a meaningful picture of the impact of inflation on reported corporate earnings. The resulting benefits in more rational tax policy, improved investor confidence in business, and better public and governmental understanding will, in my view, repay the costs of developing such a disclosure system many times over.

In addition, some modifications in our tax structure are clearly necessary to stimulate capital formation. Without attempting to be comprehensive or prescriptive, I would offer five suggestions for a plan of positive action to promote capital formation:

1. Further acceleration of depreciation schedules for tax purposes.
2. Expansion of the investment tax credit. This may entail an increase in the tax credit percentage rate, a removal of the 50 percent cap on the credit, and provision for the elilgibility of plant expenditures. The extension of the investment tax credit to plant might be especially appropriate given the latent need for wholesale replacement of aging production capacity.
3. Reduction of the corporate tax rate. Any reduction would provide some relief from double taxation and would, at least to a degree, help to undo the effects of the inflation-generated increases in the

corporate tax rate that I mentioned earlier. President Carter has proposed a cut in corporate taxation which, if enacted, would hopefully accomplish this goal.

4. Integration of the corporate and personal tax systems. In general, the effects of double taxation are a serious impediment to capital formation, and I would support steps to ameliorate the problem. I expect that, to the extent that corporations judge investments and competitive pricing policies on an after-tax basis, a substantial part of this savings might, over time, be passed to customers.

5. Retention of the capital gain treatment. Indeed, I would advocate returning the scope of those provisions to where they were earlier this decade. Much of the capital gains we tax now reflect the impact of inflation and not a true capital gain at all.

The New Economic Environment

Having talked about what government should do for business -- and may not -- let's look at what business should do for itself. I am very concerned that business, troubled by the many uncertainties it faces, is shifting into neutral waiting for the storm to pass.

Inflation is the most severe retardent to business vitality on the economic landscape. Perhaps, however, the persistence of inflation is only symptomatic of a larger change in the business climate. Nineteen seventy-seven was, after all, a good year in terms of business activity, profits, and dividends. Most sets of economic statistics were at all time highs. Not many years ago, record highs in employment, income, production, spending, savings, and financial transactions would have been reason for genuine bullishness. Today they go unnoticed.

For a long list of reasons we can all recite, we are both feeding and reflecting a lack of confidence -- indeed a crisis in confidence -- a lack of confidence in our economy, in our government, in ourselves, and in our ability to control and solve our problems. The uncertainty is particularly acute, for it was only a decade ago in the 60's that many were convinced that, at the national level, we had indeed mastered the economic cycle. Now we find that, not only have we not mastered it, but we are not certain we even understand it. Traditional cyclical theory neither explains what is happening nor forecasts what lies ahead.

And at the corporate or investor level, most things we did in the 60's turned out right, and we became impressed with our judgment and wisdom. Now those same actions turn out all wrong. And we are beginning to sense that these conditions, both macro and micro, will probably continue at least through the remainder of the business careers of the present crop of CEOs.

We have a decision to make. Do we let lack of confidence dominate our thinking? Do we "wait and see"? Do we build corporate histories of inaction and indecision? And do we indulge in self-fulfilling prophecy, collectively feed the mood of lack of confidence, and drive the economy and the society deeper into the hole while we wait for "the other guy" to show the way or for your friendly Washington public servant to give you an incentive? Or do we venture forth and find new ways to make progress in this new reality we have to live with?

We can expect much less certainty and more crises in the years ahead. Yet there will also be opportunities for progress for those who have the foresight and wisdom to look for and pursue them.

None of our problems are susceptible of easy solutions. They are part of a new, unsteady "steady state." And, those who are awaiting the return of the boom economy of the prior decade before committing themselves to positive action are making a serious mistake. In simple terms, I believe that what we should do is to recognize that we are going through a difficult and important period of economic, social, and political transition in this country -- and that the period will be prolonged and lacking in the predictability that we experienced in the post-war era. What is needed is for business to apply its very best thinking to how to prosper and have an impact in such an environment -- to have the confidence and the courage to move forward and take risks and not wait for the game to become more inviting.

In terms that a Chicago audience will understand, many corporations and chief executives may be acting like Sewell Avery. Waiting for the picture to clarify is futile and just another way of playing it safe. Walter Hoadley of the Bank of America stated the alternatives this way:

> "Each organization and individual now has a fundamental choice to make, consciously:
>
> 1. To adjust to this new era of major structural change by adopting or reaffirming a positive, aggressive posture rooted in the conviction that new opportunities can be found in changing periods and that we must learn to live with these new conditions, while not foregoing our right to try to modify and improve them; or
>
> 2. To retrench by pursuing a prolonged wait-and-see, defensive, cautious posture and very likely to partially liquidate (as at least a few companies are already doing). The consequences of this choice, if made widespread, obviously will be depressing for the general economy."

Waiting for certainty or comfort ensures the deferral of corporate growth. Piling up cash is not an end in itself and is no tribute to corporate management. Nor is a tender for your company's stock. Nor is an invitation to a take-over. If you do not put your resources to work -- in increased efficiency -- in plant and equipment -- in new products -- in marketing -- in research and development -- in acquisition -- or in expansion -- you are part of the problem. If you do not put your resources to work to express your views timely on social issues, government priorities, and regulation, and in being sure your own house is in order, the consequences are predictable.

We need to consider whether the waiting game is being overdone. We understand the lack of certainty. We understand the kind of risks that are involved. But this is the new reality, and we need to adapt to it; we need to recognize that there are opportunities within it. Our the responsibility to the company and to the company's contribution to the society call for courage and investment and not for waiting for Congress or the President to make life easier or more certain. The problem is of national and international consequence. But it originates in the individual mind, and the solution lies with you and me. Let's get on with it.

TESTIMONY OF THE HONORABLE HAROLD M. WILLIAMS, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SENATE COMMITTEE ON FINANCE, ON S. 3065

June 28, 1978

I would like to thank the Chairman and the members of this Committee for providing me the opportunity to testify in support of S. 3065, legislation which would restore capital gains taxation to the rates which prevailed prior to 1970. I should make it clear at the outset that I am testifying as an individual rather than on behalf of the SEC. The Securities and Exchange Commission has no formal role in tax policy, although it does have an obvious interest in the capital formation process -- or, more precisely, the investment process by which capital is allocated. Based in part on Commission experience, and in part on my own variety of experiences prior to coming to the Commission, I believe that legislation such as S. 3065 would contribute importantly to meeting our growing capital needs, to added confidence in the continued growth of our nation's economy, and to the necessary revitalization of our securities markets.

It would, of course, be unrealistic to argue that adjustment in capital gains taxation, or indeed any alterations in the tax code, can fully achieve these goals — but it can make a difference. A reduction in capital gains taxation of the type presently before this Committee would accomplish two things. First and foremost, it would provide increased incentive for securities investment and risk-taking. Second, to the extent that what is characterized as gain reflects the impact of inflation rather than real gain, it would reduce the confiscatory aspect of what is in part a tax on principal rather than appreciation. In my view, these would be important steps toward drawing forth additional necessary investment capital.

Our Capital Needs

With this perspective in mind, I want first to examine briefly some of the data assessing our capital needs. In 1975, the Department of Commerce prepared one of the most detailed and comprehensive discussions of investment requirements. In its "Study of Fixed Capital Requirements of the U.S. Business Economy, 1971 to 1980," the Department's

best copy available

Bureau of Economic Analysis looked at capital needs on an industry-by-industry basis. The purpose of this study was to estimate the amount of investment necessary, through 1980, in order to have an economy capable of meeting three objectives -- reasonably full employment; a national program of environmental protection; and decreased dependence on potentially unstable foreign energy sources. The Bureau found that capital investment -- that is, nonresidential fixed investment -- must average about 11.4 percent of gross national product. 1/ Capital spending has, however, not led the economic recovery, averaging less than 10 percent for the recovery period. 2/

The Department's 1975 study also contains interesting findings with respect to the uses to which new investment would be put. The study found that the majority, about 52

1/ U.S. Department of Commerce, Bureau of Economic Analysis, A Study of Fixed Capital Requirements of the U.S. Business Economy, 1971-1980, p. 7 (1975).

2/ U.S. Department of Commerce, National Income and Product Accounts, Survey of Current Business, p. S-1 (April, 1978).

percent, of capital requirements are necessary for the replacement of aged, obsolescent and inefficient productive capacity. 3/ In other words, the majority of the Department's projected national investment needs during the coming years would be employed simply to keep us from slipping below present levels. Thus, to the extent that investment is insufficient, society will pay the price in terms of fewer jobs, less productivity, a generally lower standard of living, and -- perhaps most importantly -- a perception that our economic system is not capable of satisfying our needs.

In evaluating the Department's study, it is important to bear in mind that, of the world's leading industrialized nations, the United States today has among the lowest rates of capital investment relative to gross national product, among the lowest rates of productivity increase, the lowest savings rate in relation to disposable income, and a rapidly declining rate of investment in research and development. 4/ And, these conditions exist in the country which, perhaps better than any other, understands the role

---

3/ U.S. Department of Commerce, supra note 1, at p. 5.

4/ See W. M. Blumenthal, "Address Before the Annual Conference of the Financial Analysts Federation" (Bal Harbour, Florida, May 8, 1978).

that innovation plays in producing growth and the fact that an economy that stops innovating -- regardless of how efficiently it exploits existing technology -- will stop growing. Significantly, we no longer have a large untapped pool of qualified labor and cheap natural resources and energy to draw upon as a source of economic strength. We have become a capital-limited nation in many senses of the word "capital" -- natural resources, technology, labor force, stable dollar, etc.

The Commerce Department's study is consistent with other studies. In 1977, the Council of Economic Advisers estimated that business fixed investment would need to account for 12 percent of forecast GNP during the last half of the decade to achieve full employment, reasonable growth in productivity, certain environmental objectives, and greater energy independence. 5/ In 1976, however, the actual rate of fixed business investment hit a 13-year low of 9.1 percent, and in 1977 it was 9.5 percent. 6/

I do not think it is necessary to elaborate on the economic and social price which we pay for this

---

5/ Council of Economic Advisers, "Annual Report" in The Economic Report of the President, p. 23 (1977).

6/ U.S. Department of Commerce, *supra* note 2.

slowed rate of capital investment. New investment is essential for economic development. And the ability of U.S. products to compete in world markets depends on our ability to develop new technology -- and to minimize the growth in unit labor costs -- all of which depend on capital investment. We are losing our competitive position at the same time that our research and development spending, in real terms, as a percentage of GNP has declined. 7/

Another major issue which these trends raise is whether the U.S. economy will grow in the coming decade at a rate sufficient to absorb new entrants into the labor force. Unemployment and underemployment are directly related to capital investment. Similarly, an important reason for the recent slowdown in the productivity of U.S. industry is the declining growth of capital per worker. According to the Council of Economic Advisers, the average annual growth rate for capital per worker in the private economy (after adjustment for cyclical factors) shows the following

---

7/ See W. M. Blumenthal, supra note 4.

downward trend: 1948-66, 3.1 percent; 1966-73, 2.8 percent; and 1973-76, 1.7 percent. 8/ The Council estimated that about one-third of the productivity slowdown in the last decade resulted from the slower growth in capital per labor hour. 9/

Moreover, slow rates of growth in productivity of capital per worker impact directly on what most people in and out of government regard as our number one economic problem — inflation. Increases in employee compensation -- whether in wages or benefits -- are inflationary if unmatched by increased productivity -- squeezing profits and increasing the pressure for higher prices. And lagging investment in plant and equipment fan those components of inflation which are created by capacity bottlenecks in capital intensive basic materials industries. We experienced such an effect in 1973 and 1974, and some believe we are dangerously close to repeating it.

Finally, it bears emphasis that the capital shortage problem is particularly serious for growth

---

8/ Council of Economic Advisers, supra note 5, at p. 45.

9/ Id. at pp. 45-46.

companies. The strength and vitality of growing companies -- large and small -- are key to the future of our country; they are the source of much of our technological innovation, the nucleus of new industries, and the major creator of new jobs on which both our economic and social future depend. If these crucial components of our economy are to meet this challenge, they cannot depend solely on internally generated capital -- retained earnings -- as the source of financing. For these firms, the shortage of equity capital is a matter of life and death.

We are, for example, experiencing a dearth of small company financing. In the early 1970's, these issues represented about 20 percent of the dollar value of all new issues of securities. In 1977, however, the latest year for which we have figures, new offerings by unseasoned companies accounted for only 3 percent. 10/ Similarly, in the early 1970's, over half of all filings with the SEC represented offerings by unseasoned companies,

---

10/ The staff of the Commission's Directorate of Economic and Policy Research has compiled the figures set forth in this paragraph based on a review of "Series M-180, Securities Registrations For Cash Sale" which appears in the Commission's monthly *Statistical Bulletin*.

while in 1977, such filings constituted only 24 percent of the total. Other statistics further demonstrate the plight of small companies. In 1969 alone, there were 698 underwritings for companies with a net worth of $5 million or less. In the four years 1974 through 1977, however, a total of less than 75 companies of that size had underwritten offerings. The offerings in 1969 raised over $1.3 billion, whereas the offerings for the four-year period combined to produce less than $300 million.

The Incentive to Invest

If this picture of the undesirably low rate of capital investment in our society is accepted -- and few, I think, dispute it, in principle — the problem which logically follows is to isolate the causes. The process of investing involves, for society, the sacrificing of current consumption in order to enhance future production and consumption opportunities. Just as the prudent farmer sets aside a portion of his crop for seed, society needs to put aside enough of today's income to assure tomorrow's growth. Conversely, by not providing sufficient capital for investment, we are in essence eating our seed corn.

Investors make investment decisions on the basis of the anticipated future after-tax return, considering the risk, the rate of inflation, and the return offered by alternative investment opportunities. Return can take the form of income -- that is, dividends or interest, or appreciation -- that is, capital gains, or a mix of the two. Increasingly, the capital which investors make available is in the form of loans, whereas what is needed is equity financing. In my judgment, our tax policies do not encourage investors to seek out investment opportunities involving risk, but rather relatively stable, low-risk income streams with but relatively little probability of capital appreciation. And that, in turn, discourages investment in equities and particularly in the kinds of growth industries on which the future health of both our economy and economic system depend. Such low-risk investing hits hardest at growing and dynamic companies where the need for equity capital is the greatest.

Let me restate the problem this way: Firms which must raise capital from the public to grow must be able to convince investors to put their funds at risk --

not on the basis of the certainty of a periodic dividend payment -- but on the assumption that, over time, the investor's opportunity for after-tax appreciation in the marketplace, typically from the sale of his investment, will compensate for the risk taken. If you view the marketplace today in terms of the interest rate on instruments like bonds which guarantee a fixed annual return -- the level of yield available on a no-risk or very little risk basis -- and if you contrast that yield to the return for risk-taking, after the impact of capital gains taxes and inflation, the unmistakable conclusion is that the incentive for risk-taking is inadequate to encourage individual investors to make the equity investments in growth companies that we must encourage.

There are, of course, many other important factors which impact on investor attitudes and thus on the rate of capital investment. Among these factors are: the recent discouraging record of business profitability, particularly profitability measured after-taxes and net of inflation; the perceived cost of complying with federal regulations, such as those directed to protecting our environment, health and safety, which drive up the cost of capital improvements, without directly enhancing productivity; high interest rates; fear of price controls or other direct government intrusions in the marketplace; and the uncertainties inherent in an economy characterized by high inflation. Each of these factors -- and many others could be added — increases the volitility of expected returns on investment; that is, each increases risk. Coupled with the current rates of taxation on capital gains, minimum and maximum tax provisions, and the fact that, for example, municipal debt offerings afford opportunities for low-risk yield of 6-7 percent tax exempt, it is hardly surprising that investors are less than enthusiastic about committing funds to capital investment.

Legislation to Mitigate the Impact of Capital Gains Taxation

In my judgment, legislation which lowers the tax rate on capital gains would be an important step toward readjusting the risk/return ratio in a manner which would significantly stimulate investment. Any step which increases the potential after-tax return on investment will encourage risk-taking. Similarly, a reduction in the rate at which capital gains are taxed would increase the attractiveness of capital investment as an alternative to consumption.

Further, a restriking of the balance between taxation of capital and ordinary income would indirectly aid corporations in utilizing internally generated funds for investment. It would reduce pressure for dividends by offering the stockholder greater opportunity for returns in the form of equity appreciation. Similarly, this would encourage investment in high growth companies which need to reinvest their capital and must look to a securities marketplace which reflects its confidence in investments through an enhanced price-earnings ratio.

Adjustment in capital gains taxation of the type proposed in S. 3065 would also be a step toward equalizing the opportunity for individuals to invest in equities by reducing transaction costs — that is, costs incident to disposing of one capital asset and acquiring another. The present tax structure discriminates against the individual and in favor of other major investors such as pension funds, insurance companies, and foreign investors who pay a lower tax on their capital gains, or none at all.

Moreover, any amelioration in the capital gains rate would reduce the extent to which investors are taxed on inflationary, rather than real, appreciation. At present, an investor who has held securities for a significant period of years may well find that, upon sale, he is subject to a substantial capital gains tax despite the fact that his so-called "gain" may actually represent an erosion in capital measured in constant dollars. Realistically, capital gains taxes on nominal gains during a period of inflation are a confiscatory tax on capital, not a tax on profit.

Additionally, making equity investment more attractive should stimulate securities markets and attract more money to those markets. The resulting strengthening of market depth and liquidity and stimulation to the securities industry would be valuable in themselves.

Finally, a clear governmental articulation of an appreciation for the importance of encouraging investment and rewarding risk-taking could go far to improve the psychological attitude and confidence of the marketplace and of potential investors, many of whom have been on the sidelines for years.

Reducing the Corporate Tax Rate

In emphasizing the importance of a reduction in the tax burden on capital gains, I do not want to leave the impression that I oppose other tax related steps which have been suggested as measures to stimulate capital investment. In particular, I think that a reduction in the corporate tax rate is also important to the capital problems I have described. It must, however, be recognized that corporate tax relief would serve purposes distinct from those which capital gains relief would accomplish. Reducing the corporate tax rate will directly increase after tax profits and therefore should increase the capital available for investment and the after-tax return estimates on those investments. It may increase the market value of equities but probably not the capitalization of earnings in the market as reflected in the price-earnings ratio. Tax rate relief would not significantly benefit growth companies in need of capital infusions disproportionate to what the tax relief would provide.

With regard to a reduction in the corporate tax rate, there is another point which I have emphasized in a series of talks over the last year and which I would urge this Committee to consider: In my view, the impact of inflation on the level, in real terms, of corporate profits is startling and itself a severe threat to the ability of many companies to generate and retain adequate capital internally. Inflation distorts reported corporate earnings upward in several ways. One striking element is the consistent, substantial understatement of depreciation in an inflationary environment. Similarly, inflation-generated inventory profits also overstate income. Both of these conditions erode the value of reported earnings while adding to taxable income and thus generating tax liabilities which may, in fact, have to be paid partly out of capital.

Let me illustrate briefly. If depreciation were recomputed based on the current-cost, double-declining balance method, in order to charge against revenues a sum which more accurately reflected both the manner in which capital equipment was consumed and the cost, in inflated, current dollars of replacing it, and if inventory consumption charges, as reflected in the cost of goods sold were converted from historical to current costs, 1977 after-tax profits of non-financial corporations would shrink to some $50 billion -- from the $85 billion figure reported. 11/ In effect, corporations reported as profit on the order of $35 billion required to offset or restore capital consumption.

The results of adjusting corporate earnings for inflation also have implications from the perspective of federal tax policy. Not only is business reporting the consumption of capital as income, but it is paying taxes on it. Inflation has increased the real rate of corporate taxation substantially because our tax system does not fully recognize the impact of inflation on reported earnings. It would, therefore, in my view, be appropriate for Congress to consider

---

11/ G. Terborgh, Inflation and Profits, p. 4, Table 3 (6th republication, 1978). Mr. Terborgh's study is distributed by the Machinery and Allied Products Institute. The Federal Reserve Board has apparently compiled similar data. See A. Burns, "The Need for Better Profits" (an address delivered at Gonzaga University, Spokane, Washington, October 26, 1977).

ameliorating this de facto tax increase by lowering the corporate tax rate.

Conclusion

In the 1960's, we convinced ourselves that we knew how to control the economy and economic cycles. I believe the 1970's have corrected that illusion. There is much we do not know and much we cannot prove, but we must do those things which are fundamentally logical to support and encourage investment, capital formation and the health of the private economy. In my judgment, a reduction in the burden of capital gains taxation of the type presently before this Committee is one such positive and logical step.

I appreciate this opportunity to present my views to this Committee and, of course, I would be happy to respond to any questions you may have.

APPENDIX AA.—MATERIAL SUBMITTED BY SEC CHAIRMAN WILLIAMS: PROF. D. V. AUSTIN'S STUDY OF TENDER OFFERS IN 1978-79

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

10 1 MAY 1980

The Honorable Berkley Bedell
Chairman
Subcommittee on Antitrust and
  Restraint of Trade Activities
  Affecting Small Business
Committee on Small Business
U.S. House of Representatives
B-363 Rayburn Office Building
Washington, D.C. 20515

Dear Chairman Bedell:

I have previously transmitted to you a corrected transcript of my comments before the Subcommittee on February 27 concerning tender offers, and my responses to the questions which you raised at that time with respect to possible changes in government policy in this area. I am now responding to a question raised by your staff at that hearing.

As you will recall, in response to Mr. Levine's inquiry as to the number of companies involved in tender offers, I undertook to provide such a number for the record. Accordingly, I wish to submit that almost two hundred companies annually make such tender offers, of which approximately 80% may be characterized as fully or partially successful.

Professor Douglas V. Austin, Chairman and Professor of the Department of Finance at the College of Business Administration at the University of Toledo, in cooperation with the Commission's Directorate of Economic and Policy Research, has done an extensive survey of disclosure documents on file at the Commission relating to tender offers for the years 1972-1979. For your

The Honorable Berkley Bedel
Page Two

information, I have included herein the results of that survey.

With best wishes.

Sincerely,

Harold M. Williams
Chairman

Attachment

RECEIVED
MAR 31 1980
MAIL PROCESSING SECTION S.E.C.

TENDER OFFERS IN 1978-1979

By

Dr. Douglas V. Austin
Chairman and Professor
Department of Finance
College of Business Administration
University of Toledo
Toledo, Ohio

January 17, 1980

[Attachments to this study are retained in the Subcommittee's files.]

TENDER OFFERS IN 1978-1979

Tender offers for control of corporations continue to be a dominant form of conflict and corporate warfare. As a student of tender offer trends, this author has collected data concerning tender offers since 1956. The purpose of this article is to bring the reader up to date as to what has taken place in 1978 and 1979, and to present to the reader quantitative analysis of the 1978-1979 tender offers. In order to put the materials into perspective, some analysis of previous years' tender offers are included to indicate trends in tender offer analysis and warfare. After explanation of the quantitative trends in tender offer analysis in 1978 and for the first half of 1979, some tentative conclusions as to the future trends of tender offers will be explored.

The analysis in this article covers the period January 1, 1978 through June 30, 1979. Since all the tender offer data must be gathered at the Securities and Exchange Commission from 14-(d) schedules filed with the Commission, there is a considerable lag between the time the information is made available to the public and the time in which the research can be done. This summer the author had several graduate assistants working at the SEC in order to compile the necessary data from the 14-(d) schedules, and the author wishes to thank Mr. Roger Spencer, Director, and Mr. Larry Cohen, liaison officer, Department of Economic Policy, Division of Corporation Finance, at the SEC for their valuable

---

*The author is appreciative to the University of Toledo for financial assistance through a faculty research grant for the provision of funds to partially assist in the preparation of the research necessary for this article. Also, vast credit should be given to MBA candidates Thomas R. Daney, Mark S. Mandula, and Albert N. Thomas for their invaluable assistance in the collection and preparation of the financial data associated with the Tender Offer Study for 1978-1979. The views are the author's, and not those of the University of Toledo or the MBA candidates.

cooperation and hospitality in order to be able to provide the corporate public with the information. Note also to the readers of this article that the individual corporate analyses are available from the author covering not only the period 1978-1979, but also previous years, at a nominal charge. This data covers the individual corporate tender offer statistics for each tender offer from 1972 through June 30, 1979, and are available by writing the author at the University of Toledo.

The Totals

From 1956 through June 30, 1979, there have been 1,148 inter-firm tender offers. Excluded from this total are intra-firm tender offers for the reacquisition of Treasury securities by corporations, the original tender offer technique.

In 1978, there were 166 tender offers for control or "mop-ups" compared to 181 tender offers in 1977. In the first half of 1979, the number dropped to 56 tender offers, which, on an annualized basis, would be a reduction from 166 to 112, a significant decline. On the other hand, except for the first half of 1979, the trend of tender offers as a method of acquiring control of other corporations remained strong as such a method in contrast to the early '70s. Table 1 notes the total number of tender offers from 1956 through June 30, 1979.

Table 2 classifies the tender offers as to whether they are original tender offers for control, with information available, tender offers for additional securities, including swallow-ups and mop-ups, standard offers subject to unavailability of information, and tender offers where information was exclusively relegated to the filing of a Schedule 14-(d) and no additional information was ever obtained. Since 1978, our analysis has been able to uncover all information for 53.6% of all tender offers (89 out of 166 offers), while complete information was available on 57 subsequent tender offers (mop-ups), for 34.34%. Incomplete information was available on 13 tender offers, and in only 7 cases out of 166 was there no information available from analysis. Thus, during 1978 over 93% of all the tender offers were analyzed to some degree, and 88% of the tender offers had complete information. In 1979, information was available completely on either original or subsequent tender offers in 88% of all the cases, allowing for generalization of conclusions reached based upon the data gathered.

Cash tender offers are still the most prevalent and significant form of tender offer techniques utilized by corporate managements. In 1978, of the 166 tender offers for control of other corporations, 153 were for cash, or 92.2%. During the first half of 1979, of the 56 tender offers, 52, or 92.9% were for cash. In 1976, cash tender offers accounted for 92.1% of all tender offers, while in 1977 this had 83.8 %. During 1978, exchange offers accounted for only 7.8% of all the tender offers, but this is up from previous years of the decade. Of the 13 exchange tender offers in 1978, three were for a combination of cash and either debt or equity securities. Note from examination of Table 3 that 1978 showed an increase in the number of combination tender offers, although the absolute numbers are not great. During the first half of 1979, two of the 12 exchange tender offers were of the combination variety. This author is of the opinion that the increased use of exchange tender offers during 1978-1979 is a reflection of the lack of necessity for secrecy and surprise and quick completion in some states where state anti-tender offer statutes dictate the amount of timing of the tender offer, thus not mitigating the utilization of registration of securities with the SEC, as was prevalent during the first half of the '70s.

Tender Offer Results - The Targets Still Lose

Table 4 indicates the results of tender offer outcomes since 1956. As has been noted by this author in previous studies, tender offers, regardless of the Williams Act or state anti-tender offer statutes still heavily favor the corporate bidder. For example, in 1978, 103 of the 150 tender offers, where data was available, were completely successful, or 68.7%. Tender offers that were partially successful for the corporate bidder in 1978 amounted to 23, or 15.3%. Target corporations were successful in only 24 cases, or 16% of the time, in successfully repelling a corporate attack. Completely or partially successful tender offers amounted to 126 of the 150 tender offers analyzed, or 84% of all tender offers attempted in 1978. In 1979, 37 of the 45 tender offers that could be analyzed were completely successful, 82.2%, while one was partially successful, and seven were unsuccessful.

From 1956 through 1977, 79.0% of all tender offers were either completely or partially successful. From 1968 through 1977, 78.8%, virtually identical to the longer period, were partially or completely successful. In analyzing the tender offers from 1973 through 1977, 82.1% of all the tender offers were either completely or partially successful, and finally in analyzing the 1978-1979 tender offers by themselves, 84.0% of all tender offers were completely or partially successful. What can be implied from this analysis is that in spite of all forms of improved litigative and business defenses to tender offers, the tender offer still remains a highly successful form of corporate takeover.

Finally, when one analyzes the entire period 1956-1979, it can be seen that since data has been gathered on tender offers, 64.0% of all tender offers analyzed have been completely successful, and 15% have been partially successful, with only 20% of all tender offers being successfully repelled by the corporate targets. In fact, in recent years, in spite of all the defense mechanisms discussed in the literature, and pushed by proxy solicitation firms and financial advisors, including attorneys, the successful defense rate has fallen. In terms of numbers, of the 882 tender offers that had enough information available to permit analysis, 569 have been completely successful, and 137 were partially successful. Only 176 tender offers have been successfully defended against the corporate bidder.

Table 5 analyzes cash tender offers from 1956 through 1979, dropping from the analysis exchange offers which are more complex, more time-consuming, and subject to the vagaries of the SEC as well as the marketplace. Cash tender offers in the 1978-1979 period have been more successful than they were during earlier periods. From 1956 to 1977, 58.8% of all cash tender offers were completed successfully. In the 1973-1977 period, the completely successful rate was only 56.1% In 1978, however, 68.6% were completely successful, and during the first half of 1979 80.5% of all cash tender offers were completely successful. During the 1956-1977 period, 19.3% of all cash tender offers were partially successful, while in the 1973-1977 period 25.8% were partially successful, somewhat offsetting the slightly lower completely successful rate, while in the 1978-1979 period the partially successful cash tender offer declined to 13.5%. On the other hand, completely unsuccessful cash tender offers have been declining over the entire period. In the 1956-1977 period, completely unsuccessful cash tender offers accounted for 20.2% of all tender offers, while in the 1973-1977 period this had declined to 18.1%. During the 1978-1979 period analyzed, completely unsuccessful cash tender offers declined to 15.9% again indicating a significant degree of success by corporate bidders in relation to the successful defense by corporate targets.

As a final note on the success of cash tender offers, note that Table 3 indicates that from 1956 through 1977, 78.1% of all cash tender offers were either completely or partially successful. During the period 1973-1977, 81.9% were either completely or partially successful, and during the last year and a half, the complete or partial success rate has increased to 84.1%. Tender offers may be harder to undertake, more costly to amass, and there may be more defenses available of either the business or legal variety, but the success rate of tender offers still climbs. This ought to be a warning to corporate targets, where the handwriting is on the wall.

Comparison of the Outcomes of Contested and Uncontested Tender Offers

This author has analyzed the results of contested and uncontested tender offers since 1971. Previous research done on tender offers did not break out these two types of inter-firm tender offers, thus there is no data available for the years 1956-1971. For the reader's information, an uncontested tender offer is where there was no overt opposition by the target's board of directors, management, or other interested parties. Contested tender offers, therefore, were any form of tender offers in which there was an opposition formed by the board of directors, management, or other interested parties on behalf of the target. In the 1978-1979 period, of the 227 tender offers analyzed, 21[1] were eliminated from the totals because they were withdrawn, and 28 were eliminated because of insufficient information to categorize the tender offers.

---

[1] A note on withdrawn tender offers at this point is of value to the reader. In the 21 cases noted above, at least one bidder withdrew from a tender offer. In some cases, the data revealed that one tender offer bidder withdrew and the tender offer still was successful by a competitive bidder, while in another case the tender offer withdrawal terminated the tender offer in favor of the target corporation. Thus, even though there were 21 withdrawals during the 1978-1979 period, these statistics cannot be correlated to the total of 31 successful defenses, since in some cases there were competitive bidders for the corporate target, and not all withdrew, thus allowing the target to remain successful in

Thus, contested and uncontested tender offers totaled 175 analyzed for the period 1978-1979 with the 134 (of the 166) in 1978, and 41 (of the 56) analyzed for 1979.

Table 6 indicates that the percentage of contested tender offers has fallen precipitously since 1972. In 1972, 65% of all tender offers were contested. In 1978, the percentage had declined to 28.4%, and in 1979 to 19.5%. Without placing value judgments on the reasons for decline, let us analyze the results of contested versus uncontested tender offers. As would be expected, the outcomes of uncontested tender offers have been highly success-oriented. From 1972 to 1979, the smallest victory margin for uncontested completely successful tender offers was 60.5% in 1978. In 1979, over 80.5% were completely successful contested tender offers. Partially successful tender offers during the period 1972-1979 were somewhat more dispersed, for example, 10.0% were partially successful in 1978, and none in 1979, while in 1972 20.0% were partially successful. Overall, uncontested tender offers that were either partially or completely successful accounted for 96.0% of all tender offers during the period. It can be interpreted from this data that if a corporation through its management and/or board of directors does not oppose a tender offer, the tender offer is assured, at least partially. Totally successful defenses for uncontested tender offers, if such is actually practicable, amounted to only 4.0% over the period, but interestingly, the largest percentage of unsuccessful outcomes for uncontested tender offers took place from 1976-1977 where 6.7% and 11.9% were unsuccessful tender offers. Note that in 1978 less than 1.0% of the uncontested tender offers were unsuccessful, while for the first half of 1979, none were unsuccessful. In summary, uncontested tender offers are almost always successful, especially since 1979.

The successful contested tender offers have increased in percentage during 1978 and 1979 in regard to previous years. Although the percentage of the total number of tender offers that have been contested in recent years has fallen dramatically, the success rate even for contested tender offers has shown an increase in recent years as compared to the first part of the '70s. For example, in 1976 and 1977, only 35.0% and 22.0% of all contested tender offers were completely successful. However, in 1978, 55.3% were completely successful, and during the first six months of 1979 62.5% were completely successful. Thus, in spite of all the obstacles, the completely successful contested tender offers have shown improved results in terms of success. This increased percentage of totally successful contested tender offers has been offset in recent years by a decline in partially successful tender offers, indicating where complete success is not available, abandonment is more prevalent than acceptance of a partial victory. In 1978, the percentage of partially successful contested tender offers has declined to 21.0% and only 12.5% of the contested tender offers were partially successful during the first half of 1979. This is in contrast to the 29.2% partially successful contested tender offer average for the 1972-1977 period.

On a combined basis, completely and partially successful tender offers in 1978 and 1979 were 73.6% and 75.0%. This is in direct contrast to 1976-1977 when on a combined basis they were 50.0% and 55.5%. The 1978-1979 success rate for contested tender offers is closer to the 1972-1975 period, where tender offers were either partially or completely successful in excess of 70.0%. One explanation for the higher degree of success in contested tender offers in 1978-1979 may be the smaller sample available for analysis in the 1976-1977 period, and another explanation may be the smaller number of contested tender offers.

As would be expected, the totally unsuccessful contested tender offers returned to the 1972-1975 levels in 1978-1979. In 1978, only 23.7% of all contested tender offers were successfully defended, and 25.0% in the first half of 1979. This is in contrast to the 50.0% and 44.5% in 1976 and 1977. In the 1972-1975 period, the successful defense rate was 22.7%, while in 1978-1979 the rate was 23.9%. Overall, except for 1976 and 1977, the ability to successfully defend against a contested tender offer has remained relatively constant, although as noted earlier in this section, the number of contested tender offers has declined dramatically.

Tender Offer Premiums

Prices for tender offer targets and bidders were able to be ascertained in 162 of the 222 tender offers during 1978 and the first half of 1979. Table 7 shows the size of the tender offer bid premiums of the 162 tender offers that were able to be analyzed. In order to eliminate the bias of open market purchases prior to tender offer announcement, bid premiums were based upon the common stock price of the target corporation two weeks prior to the announced date of the bid. The author is aware that there is still some remaining bias, but the two weeks prior to the bid announcement is the same technique as utilized in previous analyses, and keep the bid premium comparisons comparable for analytical purposes. It is further recognized that in recent years there has been more of a tendency on the part of corporations, even with 13-(d) filings necessary, to purchase an investment position in a prospective target prior to the bid announcement. Thus, there would be some biased toward increased stock price, thus affecting the overall bid premium size, which would have a tendency to understate the bid premium, but the actual degree of such bid premium bias is not measurable.

Table 7, therefore, shows the bid premiums in 1978 and 1979 as compared to the periods 1968-1972, 1972-1975, and 1976-1977. Interestingly, 42.0% of all the tender offers analyzed in the 1978-1979 period had bid premiums less than 10.0% over the market price of the target stock two weeks prior to the bid. This is more than double the 19.5% of the 1976-1977 period. Furthermore, this is almost a complete reversal of the bid premiums of the 1968-1972 period, when 30.1% of all bids were 95.0% above bid premium, and 4.0% were less than 10.0%.

Tender Offer Outcomes Correlated to Cash Premiums

Table 8 shows the correlation between the tender offer outcomes and the size of the cash bid premiums. This table shows a comparison of the cash bid premiums for the years 1968-1972, 1972-1975, 1976-1977, and 1978-first six months of 1979. Also, there is a summation on Table 8 showing the entire period 1968-1979. As noted by the title of the table, this analysis is only for cash tender offers, and does not include any exchange offers taking place in the period from 1968 to 1979. In the 1978-1979 period, there were 118 cash tender offers analyzed that were completely successful. Of these 118, 21 had premiums in excess of 40.0%. In contrast, there was only one partially successful tender offer in excess of 40.0% (70%-74% range), and two unsuccessful tender offers with bid premiums in excess of 40.0% (one at the 70%-74% range and one at the 100%+ range). The size of the cash bid premium is not always indicative of the results of the tender offer. For example, during the 1978-1979 period, 57 of the 118 cash tender offers that were completely successful had bid premiums of less than 10.0%, or 48.4%. Of the 19 partially successful tender offers, 5, 26.3% had bid premiums of less than 10.0%, and six of 25 unsuccessful cash tender offers had bid premiums of less than 10.0% (24.0%). In contrast, the entire period 1968-1979 had 32.3% of all totally successful tender offers with bid premiums of less than 10.0% (91 tender offers out of 281). Out of those cash tender offers that were partially successful during the entire period, 14 out of 78 had bid premiums less than 10.0%, and during the entire period 1968-1979, 15 of the unsuccessful cash tender offers, out of the 91 analyzed, had bid premiums of less than 10.0%, or 16.5%. Although the conclusion is relatively tentative, it seems that there are more cash tender offers with smaller bid premiums, and the bidders can note that the successful and partially successful rates have increased in the 1978-1979 period, even with the lower bid premiums, and the target corporations have also shown increased success at the lower bid premiums. In essence, the cash bid premiums correlated to cash tender offer outcomes is a mixed bag, with plenty of "goodies" for both the corporate bidder and the corporate target viewpoint.

Foreign Corporation Takeovers

In a previous article[2], this author discussed the phenomenon of a foreign corporation takeover of American business. In the 1972-1975 period, there were 28 foreign corporation attempted takeovers of American corporations, and 19 were completely successful, eight were partially successful, and only one was unsuccessful. During the 1972-1975 period, the total successful rate was 67.7%, and only 3.6% were unsuccessful. Altogether, there were 28 foreign attempted takeovers out of 296 total tender offers, or 9.5%.

During the 1978-1979 period, there were 36 foreign corporations attempting to take over American corporations out of the total of 222 tender offers. This amounted to 16.2%, almost double the 1972-1975 rate. Table 9 shows the results of the foreign corporation takeover of American corporations. Of the total 36 attempted takeovers, 32, or 89.0% were totally successful. Three of the remaining four foreign takeovers were partially successful, or 8.33%, and only one corporation takeover was unsuccessful. Thus, in total 97.2% of all foreign corporation takeovers were either totally or partially successful, up from 96.4% in the 1972-1975 period. Thus, not only are almost all foreign corporation takeovers successful, but the probabilities of success of foreign corporation takeovers are greater than for tender offers in general. Specifically, 89.0% of all foreign corporation takeovers have been completely successful in the 1978-1979 period, while only 71.0% of all takeovers have been completely successful. On a combined basis, 84.1% of all takeovers during 1978-1979 were either totally or partially successful, while 97.2% of all foreign takeovers have been successful. Further exploration of this interesting phenomenon deserves academic pursuit.

---

[2] Douglas V. Austin, "Tender Offer Statistics: New Strategies Are Paying Off," Mergers & Acquisitions: The Journal of Corporate Venture, Fall, 1975, Volume 10, No. 3, page 13

Tender Offer Financing Sources

In recent years there has been increasing interest in the sources of financing utilized by corporate bidders when attempting to take over targets. Amended regulations to the Williams Act request information of the bidder as to the source of financing of the takeover, and increasingly, litigation arises when alleged conflicts of interest surface when it is ascertained that the bidder's commercial bank is, or has been, also the target's commercial bank. Thus, it was of some interest to this author to examine the sources of financing for the 1978-1979 takeover attempts by the bidders. Table 10 shows the results of a cursory analysis of the sources of financing. Information was available on 144 of the 222 tender offers. The information was ascertained from either the 13-(d) and/or 14-(d) filings by the corporate bidders, or from public sources, such as the Wall Street Journal, Barrons, or other articles concerning the takeover attempts. Of the 144 takeovers where financing sources were publicly noted, 50 of the takeovers were to be financed by a commercial bank line of credit or loan, 58 were to come from the bidder's own internal cash flow, and an additional 20 takeovers were to utilize a combination commercial bank credit and the corporation's own internal funds generation. These three forms of commercial bank credit, cash flow, or a combination, accounted for 88.89% of all known sources. In addition, in 13 cases, where the corporate bidder was a subsidiary of another corporation, the source of financing was to be from the parent, even though often the final source of credit was not mentioned. In only three cases were the sources of the financing of the takeover not ones noted above. In these isolated cases, the corporation was going to issue additional common stock, or in one case the government of the country would assist in the financing of the takeover. During the 1978-1979 period, there were only 12 exchange offers which were included in the 144 offers noted above. In each and every one of these cases, interim commercial bank or cash flow sources were to be utilized before the securities were to be exchanged. Thus, they have been included as commercial bank credit or cash flow sources, rather than the ultimate exchange of securities. As can be seen from analysis of Table 10, commercial banks have played an important role in the takeovers of American corporations, as could be expected, as well as the improved liquidity of the bidding corporations themselves.

Corporate Use of Subsidiaries as Bidders

An interesting trend has developed during the last year and a half in tender offers. It is becoming somewhat evident in the 1976-1977 analysis that there has been a trend toward the use of corporate subsidiaries to bid for takeovers of other corporations. Analysis for the 1978-1979 period was done on this interesting trend, and the results are as follows: Of the 222 tender offers that were commenced during the 1978-1979 period, 97 were commenced by subsidiaries of other corporations, while 125 came from parent organizations. If one examines the 1978 versus 1979 internal trends, the trend is even more heavily towards the subsidiaries in 1979 than in 1978. In 1978, 42.0% of all bids were by subsidiaries, while in the first half of 1979, 48.0% of all bids were made by corporate subsidiaries. One reason for the increased utilization of a corporate subsidiary is to eliminate one of the target's more successful arguments, the anti-trust argument, since the subsidiary being a shell corporation, would not be in competition with the proposed target. Increasing usage of corporate subsidiaries is another area of further exploration that deserves attention in future months.

Statistical Information

In the appendix to this article, information on each of the tender offers in 1978 and for the first half of 1979 are furnished to the reader. The names of the bidders and the targets are noted, along with the date of commencement of the tender offer. In addition, the appendix contains information on each tender offer, including 1) cash or exchange type; 2) contested or uncontested, or withdrawn; 3) bidding premium percentage; and 4) outcome of the tender offer. Not contained in the appendix due to space limitations, but available from the author, utilizing the Austin Data Bank, are the following financial statistics and ratios on all tender offers in 1978 and the first half of 1979: 1) of incorporation; 2) parent or subsidiary; 3) foreign or domestic; 4) offer terms; 5) number of shares sought; 6) percent of total outstanding shares; 7) total dollars of investment involved; 8) stock price two weeks prior to bid; 9) shares held at time of offer; 10) prior investment by bidder; 11) orogimal or follow-up tender; 12) source of funds; 13) results and developments; 14) total holdings and percent; 15) three years' operating performance of target corporation in the following categories - sales, profit margins, rate of return on assets, rate of return on equity, dividends, current ratio, book value, payout ratio; 16) industry averages for same financial ratios for comparability with target corporation's performance. In addition, data has been gathered on SIC codes, stock premiums, price earnings ratios, and the Exchange or OTC classification of target. Such information will be utilized by this author for further exploration of 1978-1979 tender offers in comparison to previous tender offers, but the statistical information is available from the author at a nominal charge to cover research and reproduction costs.

Summary and Implications

The following summary and implications can be drawn from the above analysis:

1. Tender offers in 1978 totalled 166, down from 181 in 1977. For the first half of 1979, there were 56 tender offers, a decline on an annualized basis from 1978, reflecting further litigative use and stronger defense mechanisms in 1979, as well as uncertainty in the economy.

2. Cash tender offers remain the most prevalent form of tender offer mechanism, accounting for 92% in 1978, 93% in 1979, up from 84% in 1977, but in line with the 92% in 1976. As long as corporations can either borrow funds on an interim basis, or have the corporate liquidity through

internal cash flow, cash tender offers, which are by far the most efficient method of tender offer, will continue to be the most prevalent and successful form of tender offer.

3. An increase in the use of the exchange tender offer, including combination tender offers, is indicated in the 1978-1979 analysis, based upon less need for secrecy, surprise, and quick action, because of the state tender offer statutes, and a more orderly fashion of attack.

4. The tender offer is a highly successful form of corporate takeover, more readily acceptable by the American public than in previous years, and the success or partial success of tender offers still remains above 80%, even though increased defensive mechanisms have been utilized by corporate managements and their consultants/lawyers. There is no indication that the passage of time has eroded the effectiveness of the tender offer. It is this author's opinion that in the years to come, in spite of even recent changes and the Williams Act regulations, there will be continued successful takeovers by corporations because of the very nature of the phenomenon.

5. Completely successful tender offers increased in importance during 1978-1979, while partially successful tender offers declined in importance. Note that throughout the period of time, the rate of successful defense of tender offers has continued to decline, to a point where it was only 15.9%. In spite of increased defensive techniques, a larger percentage of tender offers that are accomplished are successful, with less partially successful.

6. Contested tender offers have continued to decline since 1972. By 1978, they accounted for only 28.4% of all tender offers, and in the

first half of 1979, only 19.5% of all tender offers. The remainder of all tender offers accomplished by corporate bidders of the uncontested variety, with offsetting factors affecting the responses of target corporation boards of directors as to whether to contest such bids played a large role in the determination of the contested/uncontested tender offers.

7. During the period 1972-1979, over 96% of all uncontested tender offers have been successful or partially successful. This means that less than 4% of all tender offers which were not contested by corporate management failed for one reason or the other. Thus, if you are corporate management and do not attempt to combat a tender offer takeover, your chances of survival are less than one in 25. Even worse, there was less than 1% chance in 1978 of survival if uncontested, and in the first half of 1979 no uncontested tender offers were successfully defended by corporate managements.

8. Successfully contested tender offers have risen in percentage in 1978 and 1979, while partially successful contested tender offers have declined. There is a trend towards more abandonment of less than complete victories by tender offer bidders, although overall successfully contested tender offers have continued to decline.

9. In spite of all the defenses, completely and partially successful contested tender offers have been successful about three-quarters of the time. This means that if there is a challenge to a corporate takeover, it is either successful or partially successful at least 75% of the time, which is significantly below the 96% totally successful and partially successful rate of uncontested tender offers, but a high enough percentage win rate to scare any corporate target management or board of directors.

10. During the 1978-1979 period, over 42% of all tender offers had bid premiums of less than 10%. This is more than double the 19.5% in 1976-1977, and a complete reversal of the 1968-1972 analysis.

11. Bid premiums on cash tender offers have been more successful at lower bid premium rates for completely successful tender offers as well as partially successful tender offers, while successfully defended cash tender offers have also shown better results at lower bid premiums. The results tentatively indicate success for both the bidder and corporate viewpoints, supporting that additional research would be of assistance in determining other factors which determine the bid premiums and their successes.

12. Foreign tender offers of American corporations increased during the 1978-1979 period to over 16.2%, up from 9.5% in the 1972-1975 period. Over 97% of all foreign takeover attempts have been completely or partially successful, up from 96.4% in the 1972-1975 period, and chances of surviving a foreign corporate takeover of your American business are slim in none, and Slim left town. Foreign corporation takeovers have been 97% successful while all corporate takeovers have been only 84% completely or partially successful, and this phenomenon should be studied further.

13. Commercial bank extensions of credit, cash flow, or a combination of same are almost 90% of all the sources of financing of takeovers in 1978-1979. The exchange tender offers were relatively unimportant, and even where they were utilized, often interim bank financing or internal cash flow was utilized to accomplish a corporate takeover, while long-term security takeouts were anticipated if the tender offer were accomplished. Increasingly important was the role of the parent corporation providing funds to the subsidiary through downstreaming, equity or cash for purposes of tender offer takeovers.

14. The most interesting trend arising in 1978-1979 was the increasing use by corporations of subsidiaries to undertake tender offers. In 1978, more than 42% of all tender offers were commenced by subsidiaries of other corporations, and this had risen to 48% in 1979. The use of subsidiaries for tax reasons and for elimination of anti-trust charges are two reasons for such increasing trend, but further research needs to be done on the popularity and "fad" of this technique.

In conclusion, tender offers still remain the most fascinating aspect of corporate warfare at the commencement of the 1980 decade, and in spite of all attempts to neutralize its effectiveness through increased legislation at the federal and state levels, and commensurate and concurrent regulation, tender offers still thrive as a phenomenal weapon for corporate control and change.

TABLE 1
TOTAL NUMBER OF INTER-FIRM TENDER OFFERS

Year	Number
1956	2
1957	0
1958	3
1959	4
1960	7
1961	8
1962	10
1963	21
1964	12
1965	35
1966	45
1967	86
1968	62
1969	49
1970	15
1971	6
1972	29
1973	80
1974	68
1975	71
1976	132
1977	181
1978	166
1979	56*
1956-1979 Total	1,148

*Six-month total

Source: Austin Data Bank

TABLE 2
TENDER OFFER CLASSIFICATION

Year	Inter-firm Tender Offers With Complete Information	Inter-firm Control Extensions	Tender Offers: Subject to Unavailability of Information	Tender Offers: 14-d with No Further Information Available	Total
1978	89 (53.61%)	57 (34.34%)	13 (7.83%)	7 (4.22%)	166 (100.00%)
1979*	34 (60.71%)	15 (26.79%)	7 (12.50%)	0 (0.00%)	56 (100.00%)
	123 (55.41%)	72 (32.43%)	20 (9.01%)	7 (3.15%)	222 (100.00%)

*Six-month totals

Source: Austin Data Bank

TABLE 3
GROWTH OF TENDER OFFERS
1956-1979

Year	Cash	%	Exchange	%	Combination	%	Total	%
1956	1	50.0	1	50.0	-	-	2	100.0
1957	-	-	-	-	-	-	0	100.0
1958	3	100.0	-	-	-	-	3	100.0
1959	4	100.0	-	-	-	-	4	100.0
1960	5	71.4	2	28.6	-	-	7	100.0
1961	6	75.0	2	25.0	-	-	8	100.0
1962	8	80.0	2	20.0	-	-	10	100.0
1963	19	90.5	2	9.5	-	-	21	100.0
1964	9	75.0	3	25.0	-	-	12	100.0
1965	31	88.6	4	11.4	-	-	35	100.0
1966	29	64.4	16	35.5	-	-	45	100.0
1967	76	88.4	10	11.6	-	-	86	100.0
1968	33	53.2	27	43.5	2	3.2	62	100.0
1969	19	38.8	29	59.2	1	2.0	49	100.0
1970	7	46.7	7	46.7	1	6.6	15	100.0
1971	1	16.7	5	83.3	-	-	6	100.0
1972	11	83.3	2	16.7	-	-	13	100.0
1973	57	96.6	2	3.4	-	-	59	100.0
1974	53	91.4	5	8.6	-	-	58	100.0
1975	39	92.8	3	7.1	-	-	42	100.0
1976	117	92.1	9	7.1	1	0.8	127	100.0
1977	150	83.8	25	14.0	4	2.2	179	100.0
1978	153	92.2	10	6.0	3	1.8	166	100.0
1979*	52	92.9	2	3.6	2	3.5	56	100.0
Total 1956-79	882	82.9	168	15.8	14	1.31	1,064	100.0

*Six-month total

TABLE 4
TENDER OFFER OUTCOMES
1956-1979

Year	Total	Successful		Partially Successful		Unsuccessful		Combined Successful & Partially Successful	
	No.	No.	%	No.	%	No.	%	No.	%
1956	2	2	100.0	-	-	-	-	2	100.0
1957	-	-	-	-	-	-	-	-	-
1958	3	1	33.3	1	33.3	1	33.3	2	66.7
1959	4	3	75.0	1	25.0	-	-	4	100.0
1960	7	5	71.4	-	-	2	28.6	5	71.4
1961	8	4	50.0	2	25.0	2	25.0	6	75.0
1962	10	6	60.0	2	20.0	2	20.0	8	80.0
1963	21	18	85.7	1	4.8	2	9.6	19	90.5
1964	12	6	50.0	1	8.3	5	41.7	7	58.3
1965	35	30	85.7	-	-	5	14.3	30	85.7
1966	45	29	64.4	9	20.0	7	15.6	38	84.4
1967	86	53	61.6	11	12.8	22	25.6	64	74.4
1968	62	37	59.7	2	3.2	23	37.1	39	62.9
1969	49	33	67.3	2	4.1	14	28.6	35	71.4
1970	15	13	86.7	-	-	2	1.3	13	86.7
1971	6	6	100.0	-	-	-	-	6	100.0
1972	20	13	65.0	4	20.0	3	15.0	17	85.0
1973	56	31	55.4	16	28.6	9	16.0	47	83.9
1974	55	27	49.1	18	32.7	10	18.2	45	81.8
1975	25	15	60.0	6	24.0	4	16.0	21	84.0
1976	99	63	63.6	18	18.2	18	18.2	81	81.8
1977	67	34	50.7	19	28.3	14	20.9	53	79.1
1978[1]	150	103	68.7	23	15.3	24	16.0	126	84.6
1979*	45	37	82.2	1	2.2	7	15.6	38	84.4
Total 1956-1979	882	569	64.5	137	15.5	176	20.0	706	80.0
Total 1973-1977	301	170	56.5	77	25.6	54	17.9	247	82.1
Total 1968-1977	453	272	60.0	85	18.8	96	21.2	357	78.8
Total 1956-1977	686	429	62.5	113	16.5	144	21.0	542	79.0
Total 1978-1979	195	140	71.8	24	12.3	31	15.9	164	84.1

[1] Total includes inter firm tender offers with complete information (123) and follow-up [illegible] Not included are offers with insufficient data [illegible].

*Six-month figures

TABLE 5
SUCCESS OF CASH TENDER OFFERS
1956-1979

Year	Successful		Partially Successful		Unsuccessful		Combined Successful & Partially Successful	
	No.	%	No.	%	No.	%	No.	%
1956	1	100.0	-	-	-	-	1	100.0
1957	-	-	-	-	-	-	-	-
1958	1	33.3	1	33.3	1	33.3	2	66.7
1959	3	75.0	1	25.0	-	-	4	100.0
1960	4	80.0	-	-	1	20.0	4	80.0
1961	3	50.0	1	16.7	2	33.3	4	66.7
1962	5	62.5	2	25.0	1	12.5	7	87.5
1963	16	84.2	1	5.3	2	10.5	17	89.5
1964	4	44.4	1	11.1	4	44.4	5	55.5
1965	26	83.9	-	-	5	16.1	26	83.9
1966	17	58.6	6	20.7	6	20.7	23	79.3
1967	45	59.2	11	14.5	20	26.3	56	73.7
1968	15	45.4	2	6.1	16	48.5	17	51.5
1969	10	52.6	2	10.5	7	36.9	12	63.2
1970	6	85.7	-	-	1	14.3	6	85.7
1971	1	100.0	-	-	-	-	1	100.0
1972	5	45.5	4	36.4	2	18.2	8	88.9
1973	32	56.1	16	28.1	9	15.8	48	84.2
1974	24	45.3	18	34.0	11	20.7	42	79.3
1975	15	60.0	6	24.0	4	16.0	21	84.0
1976	58	63.7	17	18.7	16	17.6	75	82.4
1977	32	52.5	17	27.9	12	19.8	49	80.4
1978[1]	94	68.6	23	16.8	20	14.6	117	85.4
1979*	33	80.5	1	2.4	7	17.1	34	82.4
Total 1956-1979	450	61.9	130	17.9	147	20.2	580	79.8
Total 1973-1977	161	56.1	74	25.8	52	18.1	235	81.9
Total 1968-1977	198	55.3	82	22.9	78	21.8	280	78.2
Total 1956-1977	323	58.8	106	19.3	120	21.9	429	78.1
Total 1978-1979	127	71.4	24	13.5	27	15.1	151	84.9

[1] Total includes inter-firm tender offers with complete information (123) and follow-up tender offers (72). Not included are offers with insufficient data (27).

*Six-month figure

TABLE 6
OUTCOMES OF CONTESTED VS. UNCONTESTED TENDER OFFERS

	Successful				Partially Successful				Unsuccessful				Combined Successful and Partially Successful			
	Uncontested		Contested		Uncontested		Contested		Uncontested		Contested		Uncontested		Contested	
Year	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
1972	5	71.4	8	61.5	2	28.6	2	15.4	-	-	3	23.1	7	100.0	10	76.9
1973	18	85.7	13	37.1	3	14.3	13	37.1	-	-	9	25.7	21	100.0	26	74.2
1974	8	66.7	19	44.2	3	25.0	15	34.9	1	8.3	9	20.9	11	91.7	34	79.1
1975	5	83.3	10	52.6	1	16.7	5	26.3	-	-	4	21.1	6	100.0	15	78.9
1976	50	83.3	9	34.6	6	10.0	4	15.4	4	6.7	13	50.0	56	93.3	13	50.0
1977	27	64.3	4	22.2	10	23.8	6	33.3	5	11.9	8	44.4	37	88.1	10	55.5
1978[1]	81	60.5	21	15.6	14	10.5	8	6.0	1	0.8	9	6.8	95	71.0	29	21.6
1979*	33	80.5	5	12.2	0	0.0	1	2.4	0	0.0	2	4.9	33	80.5	6	14.6
Total 1978-1979	227	81.9	89	44.5	39	14.1	54	27.0	11	4.0	57	28.5	266	96.0	143	71.5
Total 1972-1977	113	76.4	63	40.9	25	16.9	45	29.2	10	6.8	46	29.9	138	93.2	108	70.1
Total 1972-1979	114	65.2	26	14.8	14	8.0	9	5.1	1	0.6	11	6.3	128	73.2	35	19.9

[1] Does not include 21 withdrawn offers or 26 with insufficient data.

*Six-month figure

To be Corrected

TABLE 7
TENDER OFFER BID PREMIUMS

Bidding Premium %	1968-1972^{r} No.	1968-1972^{r} %	1972^{r}-1975* No.	1972^{r}-1975* %	1976-1977 No.	1976-1977 %	1978 & 1979* No.	1978 & 1979* %
0-4	4	3.01	7	7.00	19	11.20	43	26.55
5-9	-	-	-	-	14	8.30	25	15.43
10-14	1	.75	1	1.00	9	5.30	26	16.06
15-19	1	.75	-	-	15	8.90	10	6.18
20-24	2	1.50	2	2.00	16	9.50	8	4.94
25-29	-	-	1	1.00	12	7.10	8	4.94
30-34	-	-	2	2.00	8	4.70	8	4.94
35-39	2	1.50	5	5.00	7	4.10	7	4.32
40-44	1	.75	4	4.00	8	4.70	3	1.85
45-49	1	.75	3	3.00	12	7.10	2	1.23
50-54	4	3.01	2	2.00	7	4.10	4	2.47
55-59	3	2.26	5	5.00	6	3.50	5	3.09
60-64	3	2.26	10	10.00	3	1.80	2	1.23
65-69	6	4.51	11	11.00	5	3.00	-	-
70-74	16	12.03	4	4.00	2	1.20	4	2.47
75-79	9	6,77	6	6.00	4	2.40	1	0.61
80-84	17	12.78	7	7.00	4	2.40	-	-
85-89	10	7.52	11	11.00	2	1.20	1	0.61
90-94	13	9.78	7	7.00	3	1.80	-	-
95-99	11	8.27	3	3.00	3	1.80	1	0.61
100+	29	21.80	9	9.00	10	5.90	4	2.47
Total	133	100.00	100	100.00	169	100.00	162	100.00

*Six-month totals

^{r}Revised as per S.E.C. listings 14(d)

TABLE 8
TENDER OFFER OUTCOMES CORRELATED TO CASH PREMIUM SIZE[1]

Premium	1968-1972						1972-1975^r						1976^r-1977						1978-1979*						1968-1979*					
	Successful		Partially Successful		Unsuccessful		Successful		Partially Successful		Unsuccessful		Successful		Partially Successful		Unsuccessful		Successful		Partially Successful		Unsuccessful		Successful		Partially Successful		Unsuccessful	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
100+	2	4.9	-	-	-	-	5	10.4	2	6.1	-	-	5	6.7	-	-	1	4.5	3	2.5	-	-	1	4.0	15	5.3	2	2.6	2	2.2
95-99	-	-	-	-	-	-	-	-	-	-	-	-	1	1.4	-	-	-	-	1	0.8	-	-	-	-	2	0.7	-	-	-	-
90-94	1	2.4	-	-	-	-	-	-	1	3.1	-	-	1	1.4	-	-	1	4.5	-	-	-	-	-	-	2	0.7	1	1.3	1	1.1
85-89	1	2.4	-	-	-	-	-	-	-	-	-	-	2	2.7	-	-	-	-	1	0.8	-	-	-	-	4	1.4	-	-	-	-
80-84	-	-	-	-	1	4.0	-	-	1	3.1	1	5.3	1	1.4	1	4.5	-	-	-	-	-	-	-	-	1	0.4	2	2.5	2	2.2
75-79	-	-	-	-	-	-	-	-	1	3.1	-	-	2	2.7	1	4.5	-	-	1	0.8	-	-	-	-	3	1.1	2	2.5	-	-
70-74	-	-	-	-	-	-	1	2.1	-	-	1	5.3	2	2.7	-	-	-	-	2	1.7	1	5.3	1	4.0	5	1.8	1	1.3	2	2.2
65-69	-	-	-	-	1	4.0	1	2.1	2	6.1	2	10.5	4	5.4	1	4.5	-	-	-	-	-	-	-	-	5	1.8	3	3.8	3	3.3
60-64	-	-	-	-	-	-	1	2.1	1	3.1	2	10.5	1	1.4	-	-	-	-	2	1.7	-	-	-	-	8	2.8	1	1.3	2	2.2
55-59	-	-	-	-	1	4.0	1	2.1	1	3.1	1	5.3	2	2.7	-	-	-	-	5	4.2	-	-	-	-	8	2.8	1	1.3	2	2.2
50-54	1	2.4	-	-	1	4.0	1	2.1	-	-	1	5.3	3	4.0	-	-	2	9.1	3	2.5	-	-	1	4.0	8	2.8	-	-	5	5.5
45-49	-	-	-	-	1	4.0	3	6.3	2	6.1	-	-	4	5.4	1	4.5	2	9.1	1	0.8	-	-	1	4.0	5	1.8	3	3.8	4	4.4
40-44	1	2.4	-	-	-	-	1	2.1	4	12.1	5	26.3	1	1.4	2	9.2	4	18.2	2	1.7	-	-	1	4.0	11	3.9	6	7.7	10	11.0
35-39	1	2.4	-	-	2	8.0	8	16.7	2	6.1	1	5.2	1	1.4	1	4.5	2	9.1	1	0.8	3	15.8	3	12.0	15	5.4	6	7.7	8	8.8
30-34	6	14.6	-	-	3	12.0	1	2.1	2	6.1	1	5.2	2	2.7	1	4.5	1	4.5	6	5.1	1	5.3	1	4.0	20	7.1	4	5.1	6	6.6
25-29	4	9.8	-	-	1	4.0	4	8.3	2	6.1	-	-	7	9.5	2	9.2	2	9.1	5	4.2	-	-	3	12.0	20	7.1	4	5.1	6	6.6
20-24	7	17.1	2	50.0	4	16.0	4	8.3	2	6.1	1	5.3	6	8.1	3	13.6	2	9.1	3	2.5	2	10.5	3	12.0	28	10.0	9	11.6	10	11.0
15-19	5	12.2	-	-	1	4.0	8	16.7	3	9.1	-	-	7	9.5	-	-	4	18.2	8	6.8	-	-	2	8.0	26	9.4	3	3.9	7	7.6
10-14	2	4.9	2	50.0	3	12.0	3	6.3	3	9.1	1	5.3	4	5.4	4	18.2	-	-	17	14.5	7	36.8	2	8.0	26	9.4	16	20.5	6	6.6
5-9	4	9.8	-	-	2	8.0	3	6.3	-	-	-	-	6	8.1	1	4.5	1	4.5	20	17.0	2	10.5	3	12.0	33	11.7	3	3.8	6	6.6
0-4	6	14.6	-	-	4	16.0	3	6.3	4	12.1	2	10.5	12	16.2	4	18.2	-	-	37	31.4	3	15.8	3	12.0	58	20.6	11	15.2	9	9.9
Total	41	100.0	4	100.0	25	100.0	48	100.0	33	100.0	19	100.0	74	100.0	22	100.0	22	100.0	118	100.0	19	100.0	25	100.0	281	100.0	78	100.0	91	100.0

---

^r Revised as per S.E.C. listings 14(d)

[1] Includes only those tender offers whose bidding premium was known at time of publication

*Six-month figures

TABLE 9
FOREIGN CORPORATE TENDER OFFERS

Year	No.	Successful	Partially Successful	Unsuc- cessful
1978	28	24 (85.71)	3 (10.71)	1 (3.57)
1979*	8	8 (100.00)	0 (0.00)	0 (0.00)
Totals	36	32 (88.88)	3 (8.33)	1 (2.79)

*Six-month figure

TABLE 10
SOURCE OF FUNDS FOR TENDER OFFERS[1]

Year	Banks	%	Cash Flow	%	Combination	%	Parent	%	Other	%	Total	%
1978	40	34.78	45	39.13	16	13.91	11	9.56	3	2.62	115	100.00
1979*	10	34.49	13	44.83	4	13.79	2	6.89	0	0.00	29	100.00
Total	50	34.72	58	40.28	20	13.89	13	9.03	3	2.08	144	100.00

[1] As available on 13-d's, 14-d's, Securities & Exchange Commission files

*Six-month totals

Appendix BB.—Article by Samuel Smith: Advertising and the Conglomerates

THE RAPE OF SMALL BUSINESS: ADVERTISING AND THE CONGLOMERATES

Samuel A. Smith*

'Nonprice' Predation

The crudities of predatory pricing are, as our colleagues have pointed out above, still very much with us in a number of industries, particularly in those where the product is more or less standardized (homogeneous) in character and is sold to knowledgeable business purchasers who buy on the basis of price rather than "brand" images. In the consumer-goods industries, however, a new twist has been added in recent years: Now there's something called "nonprice predation," a variety that relies not just on the below-cost *price* to drive out small rivals but on huge *advertising* programs that (a) are too costly to be matched by those smaller competitors and that (b) have the effect of diverting enough of the latter's customers to throw them into bankruptcy.

The P&G-Folger Affair

This modern version of the old trustbuilding exercise is nowhere so well illustrated as in a recent example involving the coffee industry, one long dominated by General Foods ("Maxwell House") but also containing, in addition, a substantial number of smaller regional producers ("roasters").[1] The aggressor in this instance was Procter &

---

* Mr. Smith, a Washington attorney and a Contributing Editor of this *Review*, is the author of numerous articles in the antitrust field, including "Brand Advertising and 'Price-Performance Labeling': A Modest Proposal," *Antitrust Law & Economics Review*, Vol. 7, No. 2 (1974-75), pp. 29-46.

[1] See Dr. Willard F. Mueller, "Monopoly, Mergers, and TV Advertising: A New March to the Sea," *Wage-Price Law & Economics Review*, Vol. 3, No. 1 (1978), pp. 83-96. The details presented below of these incidents in the coffee industry, including the quotations, are all from that article by Dr. Mueller and additional citations will accordingly be omitted.

Gamble, one of the country's major conglomerates with 1977 sales of $7.3 billion and advertising expenditures of $429 million in that year. Seeing possibilities in the coffee industry, P&G entered it in 1963 by first buying out J.A. Folger & Company, a firm that had previously confined its sales largely to the western half of the United States, from the Mississippi River to the West Coast. Concerned that this acquisition of a regional coffee producer by a great marketing giant like P&G might lessen competition in the industry, the Federal Trade Commission (FTC) filed suit to break it up in 1965. Apparently believing that it had a weak case, however, the agency settled the matter in 1967, accepting a "consent" agreement under which P&G would (a) get rid of the Folger *plant* it had acquired but would (b) be allowed to keep the important "Folger" brand name.

Divine Right to 50%

It was a fatal mistake for the small coffee producers in the industry. Free now from the restraints of the FTC, Procter & Gamble thereafter began what has come to be known as a new "March to the Sea," an expansion of that acquired Folger coffee market from the Mississippi River to the *Atlantic* coast. In 1963 there had been an estimated 261 coffee producers in the United States; by 1972 their ranks had been thinned down to 162 and today there are reportedly only 40 survivors, with knowledgeable observers predicting that soon the two giants—P&G (Folger) and General Foods (Maxwell House)—will be selling over 70% of all coffee consumed in the country. The pattern of conquest has been established: P&G aggressively moved into each area or city with the intent of taking over the market and, when GF (Maxwell House) resisted by matching the P&G price cuts and saturation-advertising techniques, the smaller competitors got smashed between P&G's "hammer" and General Foods' "anvil." The former had a very simple objective in mind: "They want," commented one Wall Street analyst on the P&G invasion of the Eastern coffee market, "what's rightfully theirs—50% of the market." And since General Foods had no intention of allowing that "divine right" of P&G to be exercised at *its* expense, it was the smaller regional coffee producers who had to go under. They did.

'We Were Raped'

In 1972 the P&G coffee juggernaut invaded Cleveland "where a horrible time was had by all." In early 1973 it moved on into Philadelphia with a saturation-advertising campaign that involved TV and radio ads day and night on 14 stations, full-page (four-color) ads in the Sunday newspaper supplements, the sending of free six-ounce "samples" of Folger coffee to 1.5 million households, and the showering of "cents off" coupons (worth 25¢ each) on another one million Philadelphia residents. As reported by one of the smaller Philadelphia coffee producers at the time: "We're all bleeding to death." It was then on to Pittsburgh in 1973-74 where, in the ensuing price war and advertising blitzkrieg, an independent producer named the Breakfast Cheer Coffee Company ($12 million in yearly coffee sales) was forced to sell out. Its market share fell from 18% of the Pittsburgh market in 1971 to 1% in 1974, an experience that was summed up by one of its former officials in these words: "We were raped." Next, the battle moved on to Syracuse, New York, where P&G's various discounts and "cents off" coupons reduced the price of its Folger brand to roughly *50% of the going price* then being charged by the family-run Paul de Lima Coffee Company, one that had been founded in 1916. Cutting its own prices below the breakeven point and beginning its own TV advertising for the first time, it lost money for a while and then gave up. Its share of the Syracuse coffee market had dropped from 15% in 1974 to less than 7% by 1977. And so it went, with small business dying in the coffee industry state by state, city by city. Its overall share is now a shadow of its former self.

Advertising's Deadly Beam

A similar fate has befallen small business in virtually every industry where the product involved happens to lend itself to "differentiation," that is, to the use of advertising—and especially TV advertising—to convince the consumer that similar commodities are in some important way "different" from (superior to) other versions made by the smaller producers. Thus one researcher, dividing a sample of all manufacturing industries into two groups, those that make "producer" products (the kind bought by other manufacturers as inputs) and those turning out "consumer" products (the kind that are sold directly to the ultimate consumer), found that 66% of the latter category had experienced a substantial drop in the number of firms doing business there in recent years. More specifically, these industries had lost 12,000 firms in the 25 years between 1947 and 1972, their total business population dropping from 50,000 in the former year to 38,000 in the latter.[2]

Death of the 20,000

The food manufacturing sector is of course a prime example of this latter phenomenon. Again taking the 25 year period between 1947 and 1972, the total number of firms engaged in the manufacturing of food has dropped from 41,147 to 23,326, a decline of nearly 50% and representing the death of nearly 20,000 small businesses.[3] These surviving 23,000 food manufacturers use nearly 70% of the nation's total farm output, employ a labor force of 1.6 million, and the value of their output at the consumer level is $280 billion per year, a sum that represents 21% of *all* consumer expenditures. This largesse is not, however, evenly distributed among the

---

[2] Id., pp. 85-86.

[3] Drs. Russell C. Parker and John M. Connor, "Conglomeration and Consumer Loss in the Food Manufacturing Industries," Statement before the Senate Subcommittee on Antitrust and Monopoly (April 6, 1979), p. 3. The data and quotations presented in the following pages on the food industry are all based on this paper together with the Parker monograph referenced in note 4, below, and further page citations as such will accordingly be omitted. Inquiries regarding these two papers should be addressed to Dr. Parker, Federal Trade Commission, Washington, D.C. 20580.

23,000 producers in question: The 50 largest, including a number of our larger conglomerates, accounted for 63.7% of the industry's total assets in 1978 (up from 42% in 1963) and the *200 largest of them now hold 81.1% of those industrywide assets* (up from 67.9% in 1963). This latter group also accounts for 85% of all media advertising in the industry and 100% of all network TV advertising in it. If the exodus of small business from food manufacturing continues at the present rate (3.2% decline per year) for another decade, its population will have been cut in half again, representing the death of another 10,000 small enterprises.

Sanitizing the Food Industry

Three factors are primarily responsible for this decimation of small-business' ranks in this key sector of the national economy, namely, changes in technology, mergers, and TV advertising. On the first point, there was a precipitous drop of about 25% in the number of food manufacturers after the World War II years of 1939-45, a period in which war-production priorities had prevented the introduction of new equipment. When that War ended and the pent-up demand it had produced was encountered, new processing machinery was introduced on a large scale, much of it requiring substantially larger volumes of output in order to justify the costs of installing it and thus increasing the size that a firm had to reach in order to produce at the lowest possible unit costs. Many of the smaller firms found that their existing facilities were thus hopelessly obsolete and elected to sell out rather than attempt the large-scale and costly modernization programs that would have been required to remain competitive in their respective industries. In the milk industry, for example, the new types of machinery and facilities required by the government's newly-upgraded *sanitation* requirements had this effect of greatly enlarging the minimum-efficient scale of operation and thus effectively put out of the processing business the bulk of the country's producer-distributor (farmer) members of the industry.[4]

---

[4] Dr. Russell C. Parker, "The Status of Competition in the Food

Mergers and the Food Oligopoly

By the late 1960s, however, this early post-war exodus of the inefficiently-small enterprises from food manufacturing had been largely completed and thereafter the firms that continued to disappear included those with both small and large plants.[5] What was disappearing here was not so much the plants themselves as the firms that owned them, a phenomenon that is illustrated by the soft-drink bottling industry, one where the number of *company* exits between 1967 and 1972 exceeded the number of *plant* exits by 73. In short, the merger movement had begun again in earnest: Counting just the *large* mergers (those involving the acquisition of a firm with more than $10 million in assets), there had been 69 such mergers in food manufacturing during the 17 year period 1948-65; in the 12 year period 1966-77, that number had risen to 148. By 1972 almost two-thirds of all food manufacturing sales came from individual food industries that are classified as concentrated (oligopolistic) or, put another way, only 36% of all such sales are made by that sector's *competitive* (unconcentrated) industries. Of the 20 major industry "groups" that make up the whole of U.S. manufacturing, food manufacturing now ranks fourth in terms of *average* industry concentration, with the four largest firms holding, on the average, 52% of industry sales there (up from 47% in 1958).[6]

Manufacturing and Food Retailing Industries" in Louis J. Unker (Ed.), *Political Economy of Food and Energy* (Ann Arbor: University of Michigan Press, 1976), p. 5.

[5] The food industry is characterized by relatively large plants as compared with the rest of the country's manufacturing sector. In 1972, for example, the average food-processing plant had sales of $5.2 million, roughly *twice* the sales volume of the average plant in the remainder of U.S. manufacturing. The food sector consists of 47 separate four-digit SIC "industries" (e.g., breakfast cereals, canned fruits and vegetables, and the like) and its aggregate sales of $115 billion in 1972 constituted 15.2% of all U.S. production in that year. Id., pp. 3, 8.

[6] Parker and Conner, supra. "By 1975 at least 40% of the total assets of the 100 largest food manufacturers were attributable to mergers occurring between 1950 and 1975. Were it not for these mergers and had the largest companies not replaced merger expansion by internal growth, asset concentration of the 100 largest food manufacturers would have been *lower* in 1975 than it was in 1950." Id., p. 8.

Coming of the Food Conglomerates

The food processing sector has become, moreover, increasingly "conglomerated," with virtually all of those controlling the coveted "top four" spots in its various constituent industries being held by the same group of its "50 largest" giants that, together, account for twice as much of its overall assets (63.7% of the total) as their other 20,000 or so competitors combined. And because industry profitability is related to concentration levels, it is precisely in the most highly concentrated of these industries that the top 50 hold the largest proportion of those dominant market shares. Of their 25 largest members, 13 of them operate in from six to ten separate four-digit SIC food manufacturing industries, nine of them are in 11 to 20 such separate industries, and three of them are producing in over 20 of the sector's 47 different food industries. Many are also producers of nonfood products and a number have merged their way into such areas as the operation of fast-food chains: Pillsbury now owns Burger King, Heublein owns Kentucky Fried Chicken, ITT owns the Sheraton Inns and Hotels, General Foods owns Burger Chef, Great Western owns Shakey's Pizza, Riviana Foods owns Lum's, and Pet owns Stuckey's.

Barring Small Business

The third major factor that accounts for the demise of small business in this key sector of the economy is advertising, particularly TV advertising.[7] An estimated total of $13 billion was spent in the advertising of food products in the U.S. in 1978 (up from $2 billion in 1950) and the *first-year* costs of launching a single new consumer food product often exceeds $20 million today. Small firms, and particularly new entrants, are generally unable to invest such sums in promotion and thus find themselves unable to adequately inform consumers of their product offerings. Their bigger rivals, being able to "spread" their total advertising expenditures over a larger volume of sales, typically enjoy a substantially lower *per-unit* cost here. If the smaller firm attempts to "match" these huge promotional expenditures, it thus finds itself at a significant *cost* disadvantage. If it *doesn't* do so, however, it tends to lose market share to the more intensely-advertised "brands" sold by those larger marketing conglomerates. "The main effect of high promotion and product differentiation costs is that they cause consumers to have *strong preferences* for brands of particular sellers and most especially for brands of established sellers versus new entrants. This creates insulation against the encroachment of actual or potential competitors and thus gives the company that advertises higher profits due to its ability to charge higher prices without losing market share."

---

[7] Total advertising expenditures in the U.S. amount to some $30 billion per year, with TV accounting for somewhat less than a fifth of that overall figure.

Doubling the Ad Budget

These two techniques of monopolization, mergers and high-intensity advertising, are frequently *combined* to quickly convert a previously competitive industry into an effectively monopolized one. Observing that an industry's product is one that lends itself to "differentiation" via massive doses of advertising, the outside conglomerate begins by first acquiring one of its leading insiders and then proceeds to launch a promotional campaign that will (a) inflate the costs and thus ultimately bankrupt the smaller firms if they attempt to match it, (b) dry up their market shares if they don't, and (c) give the invader both an overwhelming share of the industry's sales *plus* a "brand" image of sufficient strength to permit those mass sales to be made at a substantially higher *price* than can be commanded by the equal-quality (but less-intensely promoted) products of the smaller sellers. Thus the average amount of advertising money expended on a given brand tends to be *doubled* within a year after its acquisition by a marketing conglomerate. The result, of course, is a drastic shrinkage in the number and size of the small enterprises in the industry and an equally substantial increase in the prices paid by the consuming public for the product in question.

A $15 Billion Monopoly Drain

The table below lists the percentages by which the prices in a variety of the food industries are estimated by the economic experts here to exceed the level that would have prevailed if those industries had remained unconcentrated (competitive), i.e., if the bulk of their sales volume had remained in the hands of *small* businesses rather than large ones. These numbers represent, in short, the size of the "monopoly overcharges" currently being exacted from consumers in each of those industries or, looked at another way, they represent the size of the *opportunities* available to small business there *if* it could discover a way to overcome the entry (and expansion) barriers maintained around those industries by the larger firms that currently dominate them. In breakfast cereals, for example, the size of this "gap" between the monopoly price currently being charged and the actual cost of producing and selling the product (including a normal or competitive rate of return on the capital required) is estimated at 29% or more. Similarly, alcoholic beverages are estimated to be overpriced by 14% to 24%, prepared flour mixes from 21% to 26%, soft drinks from 15% to 19%, and coffee from 16% to 18%. Industrywide, these overcharges are estimated at 5.7% of all household food expenditures. In dollars, the conclusion here is that the "consumer loss due to monopoly in the U.S. food manufacturing industries in 1975 was at least $10 billion but possibly as high as $15 billion."[8]

---

[8] Id., pp. 20-22. Again, however, it should be noted that while the reported *profits* in food manufacturing are somewhat higher than in U.S. manufacturing as a whole, the price "overcharge" is an entirely different—and invariably much higher—figure than would be presented by the simple measure of excessive profits: "The overcharge is a transfer of income from consumers to manufacturers with market power. However, just *how much* of the overcharge the manufacturers take home *as profits* depends on how much higher their average *costs* are compared to what they would be under competition. Over 200 years ago, Adam Smith described monopoly as the great enemy of good management. By that he meant that monopolists do

Table 1

Estimates of Wholesale Price Elevation Due to Monopoly in the U.S. Consumer Food Manufacturing Industries, 1975

Industry Categories	Percentage Elevation in Wholesale Prices Due to Monopoly	
	Estimate #1*	Estimate #2**
Meatpacking	0.0%	0.0%
Meat Processing	5.6%	1.6%
Poultry & Egg Products	0.0%	3.6%
Fluid Milk	5.3%	7.8%
Other Dairy Products	3.2%	8.9%
Canned Fruits & Vegetables	5.4%	11.2%
Other Canned & Dried Foods	16.0%	16.1%
Flour Mixes	21.9%	26.2%
Breakfast Cereals	29.0%	29.5%
Pet & Animal Foods	8.6%	20.0%
Other Grain Mill Products	8.6%	16.3%
Bread, Rolls & Cakes	3.7%	5.9%
Crackers & Cookies	16.3%	21.2%
Sugar	3.4%	9.0%
Candy & Chewing Gums	16.2%	20.1%
Oils & Margarine	9.1%	20.4%
Beer	18.8%	12.5%
Wine	11.3%	12.2%
Other Alcoholic Beverages	24.2%	14.3%
Soft Drinks & Flavorings	19.3%	15.3%
Coffee	18.8%	16.6%
Other Processed Foods	12.6%	13.2%

---

* Price-Cost Regression Equation.

** National Brand Versus Private Label Regression Equation.

Source: Drs. Russell C. Parker and John M. Connor, "Conglomeration and Consumer Loss in the Food Manufacturing Industries," Statement before Senate Subcommittee on Antitrust & Monopoly (April 6, 1979).

Diverting the Capital Flow

It will be obvious that this drainage of $15 billion out of the food consumer's pocket by the 200 or so major food conglomerates carries a heavy price tag *for small business as a whole.* "Food is a basic necessity (a wage good) consumed by all roughly in proportion to dietary needs regardless of income or wealth. The *income transfers* go to relatively few, higher-income individuals." The consuming public as a whole has $15 billion *less* to spend each year than it otherwise would have had and, whereas those ordinary citizens would have spent virtually all of it had it remained in *their* hands (much of it on goods sold by the small-business sector in general), the higher-income executives and stockholders of these giant food conglomerates can be expected to have a much higher "propensity to save" and thus to divert this vast

---

not have as strong incentives to minimize their costs as do competitive firms. Besides the technical inefficiency due to lax management, the monopolists' higher costs often include excessive expenditures on advertising, the cost of excess plant capacity, excessive wage settlements, and costs of other strategies which *protect the monopolists' profits from encroachment by competitors*. Moreover, monopolistic firms often allow managerial withdrawals in the form of fancy offices, corporate jets, and other inessential perquisites." Id., p. 18.

It should not go unobserved, however, that not *all* of the monopoly-overcharge money gets wasted. A 1969 study by the Federal Trade Commission (FTC) reported, for example, that profits in food manufacturing are in fact highly correlated with both (a) concentration levels and (b) advertising intensity. Indeed, the profit rate in the *most* completely monopolized food industries (four-firm concentration levels of over 70% *plus* expenditures on advertising of 5% or more of sales) tends to be nearly *three times* the long-term profit rate of the *least* concentrated ones (four-firm concentration under 40% and 1% or less of sales spent on advertising). Parker, supra, pp. 28-30. It should also be noted that these larger food manufacturers engage in only the most minimal amount of R&D and do virtually no real innovating. "The picture that emerges" from the industry, in other words, "is that large food manufacturers *move into new products only after they are first developed by smaller firms*. The acquiring corporations then enhance the market positions they acquired through competition-reducing advertising and other forms of product differentiation... The implication of complacent conduct is not only higher costs in the present but even higher future costs due to lack of progressiveness resulting from the lack of pressure on companies to innovate." Id., pp. 19-21.

flow of money to nonconsumption uses. It is of course precisely this phenomenon of monopoly overcharges in the economy as a whole—one that, as noted, aggregates an estimated $180 billion per year—that keeps *big* business awash in available cash and thus relatively free of the need for outside credit. And it is similarly this systematic, year-by-year draining of the national capital pool by these monopoly giants that reduces the sales of *small* business, shrinks its yearly earnings, and thus prevents it from being able to generate from its own operations the capital *it* needs for start-ups and expansions. He who has the money gets to buy out those who don't.

The 'Efficiency' Scam

We must ask, however, whether this monopolization of food manufacturing described here—and by extension that of the monopolized one-third of the national economy as a whole—is a "natural" process, one that springs from the superior *efficiency* of large-scale production. These 47 different food industries have reached, as noted, a concentration level in which, on the average, the four largest firms in each account for approximately 60% of its total sales or an average of 15% per major firm per industry. Does a food manufacturing plant *need* 15% of its industry's total sales in order to get its unit costs of production as low as they can be gotten? A recent study reported that, in the average food manufacturing industry, *all such cost savings can be realized at a plant size equal to approximately 2% of industry shipments.*[9] "Efficiency" considerations alone, then, would justify here a concentration level of no more than 8% of an industry's sales in the hands of any four firms. And even if geographical considerations should arguably require each efficient-size firm to own say as many as *three* such plants, these figures would rise to only 6% of total industry sales per *firm* and, by multiplication, only 24% for any four of the industry's members. The conclusion is plain: Production efficiencies are not the explanation for the present high level of concentration in American industry and thus for the decline of small business in it.

---

[9] Parker, supra, p. 18.

The '4-Firm-40' Rule

Perhaps the most notable finding of all in these various studies of the economic experts here is that *none of the problems of monopoly appear in industries where the four largest firms account for no more than 40% of total industry sales.*[10] When price-fixing is tried in such industries, it invariably breaks down. When price discrimination occurs there, it tends to be sporadic and competitively harmless. Both prices and profits are flexible upward and downward, always gravitating back to the normal or competitive return on the capital invested. Innovation tends to flourish here and, with it, productivity proceeds at a brisk clip. Product quality is good, output is at its feasible maximum, and jobs are created at the fastest attainable pace. The forces of inflation and unemployment can and do act *upon* the competitive small-business sector but they can never *originate* in it.

Three Birds, One Stone

America has a problem. Small business has a problem. Antitrust has a problem. In the final analysis, however, they all have the *same* problem in the fundamental sense that if it was solved those others would be, too. The solution is straight-forward: *Small business must ultimately hold a minimum of 50% of the sales of each individual industry* in the economy at large. This is a more strenuous requirement, of course, than simply saying that small business must increase its share of the country's total *economywide* output (GNP) from its present 42% to 50%. The requirement, rather, is that small business must acquire that share in *each and every* constituent industry and market that makes up the great

---

[10] Id., pp. 28-30.

national aggregates including, for example, autos, steel, oil, breakfast cereals, soap, and soup. When this occurs—and, if the economic experts in these matters are to be believed, *only* when it occurs—will we have adequately resolved either the economic problems of small business, of antitrust, or of the country at large.

APPENDIX CC.—DEPARTMENT OF JUSTICE STUDY: CONGLOMERATE MERGERS, SMALL BUSINESS, AND THE SCOPE OF EXISTING ANTIMERGER STATUTES

United States Department of Justice
WASHINGTON, D.C. 20530

ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

June 20, 1979

Honorable Berkley Bedell
House of Representatives
405 Cannon H.O.B.
Washington, D.C. 20515

Dear Mr. Bedell:

I have the honor to submit the following report pursuant to the provisions of the Section 10(c) of the Small Business Act, as amended. */ That Act directs the Department of Justice to review the activities of Government for the purpose of determining "any factors which may tend to eliminate competition, create or strengthen monopolies, promote undue concentration of economic power, or otherwise injure small business." This report analyzes the competitive and social impact of mergers and acquisitions among and by our largest business enterprises, paying particular attention to the issues posed by conglomeration and to the ability of the antitrust agencies to deal adequately with conglomerate mergers under existing legislation. Generally, the report concludes that mergers among large enterprises, on balance, contribute little to economic efficiency, while enhancing the aggregate concentration of economic power and creating the potential for significant injury to small businesses. The report concludes, however, that the existing anti-merger provisions of the Clayton Act do not adequately deal with conglomerate mergers and recommends the enactment of legislation that would prohibit certain types of mergers and acquisitions by the largest businesses unless they enhance competition.

Sincerely,

John H. Shenefield

John H. Shenefield
Assistant Attorney General
Antitrust Division

REPORT OF
THE ATTORNEY GENERAL
PURSUANT TO SECTION 10 (c) OF THE
SMALL BUSINESS ACT,
AS AMENDED

CONGLOMERATE MERGERS, SMALL BUSINESS, AND THE SCOPE OF EXISTING ANTI-MERGER STATUTES

JUNE 20, 1979

CONGLOMERATE MERGERS, SMALL BUSINESSES AND THE SCOPE OF EXISTING ANTI-MERGER STATUTES

§1 Introduction 1

§2 The Conglomerate Merger Phenomenon 2

  §2.1 The current conglomerate merger wave -- its effect on economic concentration 2

  §2.2 On balance conglomerate mergers have few economic benefits for the companies involved 4

  §2.3 The cumulative effects of large conglomerate mergers may be substantial 8

§3 The Effects of Conglomerate Mergers on Small Businesses . . 11

  §3.1 Competitive effects on markets in which the conglomerate operates 11

  §3.2 Effects on customers and suppliers of a conglomerate 13

  §3.3 Effects on the conglomerate's community 14

  §3.4 Effects on government regulation 14

§4 The Prospect for Control of Conglomerate Mergers Under Existing Antitrust Laws 16

§5 Possible Legislative Remedies 18

Appendices

CHARTS

Chart A: Number of Corporate Mergers and Acquisitions Valued At $100 Million or More

Chart B: Total Value of Announced Corporate Mergers and Acquisitions

Chart C: Mergers and Acquisitions of Manufacturing and Mining Firms of Over $10 Million in Assets, 1950-1977

Chart D: Trends In Aggregate Concentration by Various Measures

Chart E: Share of Value Added Accounted for by the 50, 100, 200, 500, and 1000 Largest Manufacturing Firms

Chart F: Percent of Total Corporate Assets and Receipts Accounted for by the Largest Corporations, by Sector

TABLES

Table 1
Percentage of Sales and Assets of All Manufacturing Firms Attributable to Largest 200

Table 2
Assets of the 200 Largest *Fortune* Industrials (Ranked on the Basis of Sales) Compared with Total Assets of All Manufacturing and Mining Corporations for Selected Years

Table 3
Total Manufacturing Sales Compared with the *Fortune* 200 Largest Industrials (Ranked on the Basis of Sales) for Selected Years

Table 4
Total Assets, All Active Corporations Compared with *Forbes* 500 Biggest Corporations Ranked by Assets

Table 5
Total Receipts, All Active Corporations Compared with Forbes 500 Biggest Corporations Ranked by Revenues and Sales

Table 6
Share of Total Value Added by Manufacture Accounted for by the 50, 100, 150, 200, 500, and 1000 Largest Manufacturing Companies for Selected Years

Table 7
All Industries - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1000 Largest Corporations for Selected Years

Table 8
All Industries Less Finance, Insurance, and Real Estate - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1000 Largest Corporations for Selected Years

Table 9
Manufacturing - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1000 Largest Corporations for Selected Years

Table 10
Finance, Insurance, and Real Estate - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1000 Largest Corporations for Selected Years

Table 11
Services - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1000 Largest Corporations for Selected Years

Table 12
Wholesale and Retail Trade - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1000 Largest Corporations for Selected Years

Table 13
Transportation, Communication, and Electric, Gas, and Sanitary Services - Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200 500 and 1000 Largest Corporations for Selected Years

Table 14
Mergers in Manufacturing and Mining (Large Companies)

Table 15
Large Acquisitions in Manufacturing and Mining by Firms Ranked Among the 200 Largest Manufacturing Firms in 1975, By Year, 1948-1977

CONGLOMERATE MERGERS, SMALL BUSINESSES AND THE SCOPE OF EXISTING ANTI-MERGER STATUTES

§1. Introduction

Over the past decade, a broad spectrum of public officials, members of the academic and business communities, and the public at large has expressed increasing concern about the cumulative effect of large conglomerate mergers on the concentration of economic power in our society and about the long-range impact of such mergers on competition and on the ability of small businesses to function effectively.

The purpose of this report is to evaluate these concerns in the context of the current ability of the antitrust agencies to deal effectively with the problems raised by mergers, particularly conglomerate mergers, among America's largest businesses.

We believe that this review is a timely one. The United States has experienced several large merger waves within the last century. The first major merger wave, viewed by some as an effort to create monopolies, resulted in the passage of the Sherman Act of 1890 and the Clayton Act of 1914. The next merger wave, which has been characterized as an effort to create oligopolies by merger, led, in part, to the enactment of the Celler-Kefauver Act of 1950, which strengthened Clayton Act Section 7. As the merger waves of the late 1960's and early 1970's developed, it became clear to antitrust experts that the existing antitrust laws which had proved relatively effective against horizontal and vertical mergers were of only limited applicability to conglomerate consolidations. 1/

While that first conglomerate merger wave caused widespread public debate, no additional antitrust legislation directed at conglomerate mergers was enacted by Congress at that time, partially out of a belief that conglomerate mergers, previously a relatively unstudied phenomenon, might have overall positive benefits on economic activity. When that merger wave drew to a close, immediate public interest in conglomerate mergers diminished. Subsequently, however, analyses of the effects, both positive and negative, of conglomerates became increasingly available as the data from that period, compiled from financial reports and government statistics, was subjected to scrutiny by researchers.

1/ Merger is the consolidation of previously independent businesses under a single controlling ownership. Mergers are classified into three general categories: horizontal mergers between competing businesses, vertical mergers between businesses involved in successive stages of manufacturing and/or marketing of a product, and conglomerate mergers between businesses which are largely unrelated.

With the recent emergence of a new conglomerate merger wave, the stage was therefore set for a renewed public debate concerning the need for additional legislation to deal with merger among the largest business enterprises. The small business community has been an active participant in this dialogue.

A poll taken among the 570,000 members of the National Federation of Independent Business during early 1979 revealed that 61 percent of those responding believed that mergers by and among the largest firms should not be permitted unless proponents of such an acquisition could demonstrate that it was not anticompetitive or monopolistic. Similarly, a 1978 report of the House Committee on Small Business, Future of Small Business in America, concluded that the antitrust enforcement agencies should develop proposals to reverse the trend toward increasing aggregate concentration through mergers and acquisitions. 2/

It is to a discussion of conglomerate mergers -- their effects and the ability of the antitrust laws to deal with them -- that this report now turns.

§2 The Conglomerate Merger Phenomenon

2.1 The Current Conglomerate Merger Wave -- Its Effect on Economic Concentration

During the past few years, the number of reported mergers, especially the number of mergers involving the largest American corporations, has increased sharply. Between 1975 and 1978 the number of "giant mergers," those involving the acquisition of companies in transactions valued at $100 million or more, leaped from 14 to 80, a 500 percent gain. Overall, in that same period, the annual total purchase value for all announced mergers rose nearly 190 percent. 3/ Today's merger activity is significantly above historical averages in both absolute and relative terms, and rivals the 1968-1969 merger peaks in intensity. 4/

The principal type of merger consummated in this wave is conglomerate. In recent years, mergers involving companies engaged in businesses totally unrelated to each other, so-called "pure

---

2/ H.R. Rep. No. 95-1810, 95th Cong., 2d Sess. 40 (1978).

3/ See Charts A and B, appended.

4/ See Chart C, Table 14, appended.

conglomerate mergers," have accounted for between 45 and 55 percent of all manufacturing assets acquired in large mergers; the percentage interest is between 80 and 90 percent of manufacturing assets transferred when the other categories of conglomerate mergers, product and market extension mergers, are included. 5/

This merger activity is taking place in any economy which is experiencing a long-term trend toward an increasing concentration of economic power. In 1950, when Congress strengthened the Clayton Act, legislators expressed concern that "industrial giants" were gaining too much economic power, and that this "rising tide of economic concentration" threatened local control of business and other non-economic values. 6/ Then, Congress noted that the 316 largest industrial firms had increased their share of the manufacturing sector's working capital from 40 percent in 1929 to 47 percent in 1940. 7/ Between 1947 and 1972, however, the largest 200 American industrial firms increased their share of the nation's manufacturing assets from 46 to 61 percent. During the current merger wave, the trend has continued. By 1977 these top 200 firms controlled 62 percent of the industrial assets. 8/

Data recently made available by the Internal Revenue Service also reveals that relatively high levels of concentration exist economy-wide and that they have been increasing, or not declining significantly, in several sectors. For example, the percent of total corporate assets from all sectors of the economy attributable to the 50 largest companies grew from 20.8 percent in 1968 to 23.1 percent in 1974, and the share of the largest 500 corporations rose from 45.9 percent to 48.6 percent. In terms of total receipts during those years, the share of the top 50 went from 15.5 percent to 19.2 percent, and of the top 500, from 35.2 percent to 40.6 percent. Excluding financial, insurance, and real estate corporations, the share of the top 50's assets increased from 25.1 percent

---

5/ See Table 18, Federal Trade Commission, Bureau of Economics, Statistical Report on Mergers and Acquisitions 105 (1977).

6/ See Brown Shoe Co. v. United States, 370 U.S. 294, 315-16 (1962).

7/ H.R. Rep. No. 1191, 81st Cong., 1st Sess. 2-4 (1949).

8/ See Charts D and E, appended.

to 25.7 percent, and that of the top 500, from 53.9 percent to 55.6 percent. For receipts, the numbers were, top 50, 16.6 percent to 20.9 percent; top 500, 36.5 percent to 42.2 percent. 9/

Mergers have played a significant part, though only a part, in this growth. Studies estimate that as much as 73 percent of the increase in concentration of assets held by the largest 200 manufacturing companies during the 1950's and 1960's was directly attributable to assets acquired in mergers. 10/ Approximately 13.6 percent of the assets held by the top 200 industrial companies in 1977 were obtained by mergers. 11/ At least one study estimates that but for mergers by the 200 largest industrial companies, the overall concentration of assets held by our country's largest firms would have declined in the 1960's. 12/

In similar fashion, conglomerate mergers by large firms have served to diminish the number of decision centers in the business community. For example, from 1968 through 1977, corporations with more than $1 billion in assets acquired 160 independent industrial enterprises having assets over $10 million by means of conglomerate mergers. 13/

2.2 On Balance Conglomerate Mergers Have Few Economic Benefits for the Companies Involved

Mergers have economic value when they improve the productivity of the combining firms and thus marginally increase industrial efficiency. Horizontal mergers between competing firms and vertical mergers between firms involved in successive stages of the production and distribution of an item may sometimes permit companies to

---

9/ See Charts E and F, Tables 7 through 13, appended.

10/ Federal Trade Commission, Economic Report on Corporate Mergers 178-198 (1969). *See* McGowan, *The Effects of Alternative Antimerger Policies on the Size Distribution of Firms*, 5 Yale Econ. Essays 423 (1969); Preston, *Giant Firms, Large Mergers and Concentration: Patterns and Policy Alternatives, 1954-1968*, 1 Industrial Org. Rev. 35 (1973).

11/ Based on the purchase value of the acquired assets fully adjusted for inflation. Without adjustment the figure would be 8.2 percent. See Table 15, appended.

12/ Federal Trade Commission, Economic Report on Corporate Mergers 189-193 (1969). *See* Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. Bank. & Fin. 315, 337-338 (1977).

13/ Derived from Table 26, Federal Trade Commission, Statistical Report on Mergers and Acquisitions 119-206 (1977) and unpublished data for 1977.

achieve distribution and scale economies. These types of mergers thus may have positive economic value, though, in some cases, the value may be offset by an associated anticompetitive potential. 14/

The available evidence indicates, however, that conglomerate mergers do not promote the combining firms' productivity. A conglomerate combination does not inherently achieve economies of scale or permit more efficient production of an end product. As Professor William Cary, the former Chairman of the Securities and Exchange Commission has said, the current merger wave has "no economic *raison d'etre*." 15/ Indeed, by traditional standards, conglomerate mergers have little economic justification.

Proponents of conglomerate mergers have argued that the mergers permit companies effectively to allocate capital resources among industries, more effectively raise capital, replace inefficient management or otherwise create productivity enhancing "synergies." However, no major study has established that widespread, substantial synergies in fact exist. To the contrary, it appears that the post-merger performance of conglomerate firms has been, on average, no better and perhaps slightly worse than would be expected had the combining firms remained independent. 16/

Of course, this does not mean that every conglomerate merger is without economic value. Individual mergers may produce some productivity gains. For example, some combinations of firms give the combined firm better access to the capital market than one or

---

14/ *E.g.*, L. Sullivan, Antitrust 597-599 (1977).

15/ N.Y. Times, June 23, 1978, at A-25.

16/ *E.g.*, Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence*, 1 J. Bank & Fin. 315, 320-33 (1977); J.M. Blair, Economic Concentration: Structure, Behavior and Public Policy 185-195 (1972). *See also*, Salter and Weinhold, *Diversification Via Acquisition: Creating Value*, Harv. Bus. Rev. 166 (July-August 1978). Salter and Weinhold discuss seven "misconceptions" about the purported benefits of diversification, including the myth that conglomerates had superior productivity. *See generally* P. Steiner, Mergers 59-69 (1977).

both of the pre-merger enterprises possessed. It should be noted, however, that at least one study indicated that large conglomerate mergers do not create this benefit since the firms which combine in such transactions are usually large enough to obtain preferential financing on their own. 17/

Some proponents of conglomerate mergers argue that such mergers may be responsible for improving overall economic performance, even though the mergers do not, on average, improve the performance of the merging firms. They premise their arguments on the belief that most large, modern corporations are controlled by an entrenched group of managers. Although these managers theoretically serve at the pleasure of a corporation's shareholders, the diffused ownership structure of major corporations makes it virtually impossible for any group of shareholders to oust the incumbent executives. Thus, the only practical threat to management's continued control of the corporation may be a corporate takeover by a large, conglomerate firm. This threat of takeover, it is alleged, serves to stimulate this entrenched control group to operate their firm well: if the firm is operated inefficiently it may be valued at less than its worth and thus become a prime takeover target.

In practice, however, it appears this benefit is largely unrealized. Acquisition-minded firms, for the most part, avoid poorly performing firms since those firms often present intractable managerial challenges. 18/ Consequently, the bulk of conglomerate acquisitions may involve well-managed firms. Rather than serving to stimulate managers to try to improve performance, fear of takeover, to the extent it motivates management of potential targets, logically would act as a disincentive to corporate efficiency.

17/ P. Steiner, Mergers 64-65 (1977). See D.G. McFetridge & L.J. Weatherby, Notes on the Economies of Large Firm Size, 105-153 (1977) (Royal Commission (Canada) on Corporate Concentration Study No. 20) (increase in scale efficiency in capital formation significantly declined as firm size increased).

18/ See, e.g., Staff of Antitrust Subcomm. of the House Comm. on the Judiciary, 92nd Cong., 1st Sess., Report on Investigation of Conglomerate Corporations (Comm. Print 1971); The Great Takeover Binge, Bus. Week, Nov. 14, 1977, at 179; Hill, Why Take-overs Need Care and Judgement, Int'l. Management, May 1978, at 56; Harry J. Gray: Thoughts on Acquisitions, Financier, Nov. 1978, at 36.

Moreover, the takeover phenomenon has produced negative side effects. Successful firms that fear they may become takeover targets have attempted to reduce their attractiveness by using accumulated cash to acquire other corporations in an effort to create antitrust conflicts with likely acquirers. Such firms' managers have also engaged in extensive and expensive vigorous opposition to takeover attempts. 19/ In both circumstances, funds which could be used for the acquisition of new productive assets are effectively "wasted" in attempts to preserve corporate independence.

Early proponents of conglomerate mergers also argued that a chief benefit derived from the multimarket structure of the firm was the opportunity it created for "modern managers" to exercise their skill in a variety of markets. Managerial expertise was then believed to be relatively transferable. However, evidence soon began to indicate that "managerial ability is generally tied quite closely to the particular industry setting in which it develops and operates" and it became clear that managing a multimarket firm was a "vastly harder and more complex job" than managing a single market company since the adversities which naturally arise in any market were compounded and multiplied by the multimarket nature of the firm. 20/ Although there is still dispute, some observers maintain that large conglomerate firms may, by their very size, create an inefficient management system. 21/

19/ See, e.g., Corporate Takeovers are Here to Stay, Fortune, May 8, 1978 at 93-94; The Mounting Backlash Against Corporate Takeovers, Forbes, Aug. 7, 1978, at 32; Mergers and Industrial Concentration, Hearings before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 95th Cong., 2d Sess. 229-243 (1978) (Statement of William C. Norris) (ill effects from hostile takeovers).

20/ See The Perils of the Multi-Market Corporation, Fortune Feb. 1967, reprinted in Editors of Fortune, The Conglomerate Commotion 77-78, 85-86 (1970).

21/ E.g., Hackett, Drawbacks of Continuing Corporate Growth, 52 Harv. Bus. Rev. 6 (Jan.-Feb. 1974) noting that the large size and conglomerate nature of some firms may often produce 1) confused bookkeeping, 2) delayed decision-making, and 3) regimentation which stifles creativity.

It is also alleged that large mergers are beneficial because they create the very large industrial complexes necessary to meet the requirements of massive research projects essential to the continuation of the innovative processes of modern technology. 22/ However, a number of studies have produced results which challenge that thesis. For example, one determined that big, established companies rarely originated new technologies. 23/ Another indicated that more than half of the most significant American inventions were produced by small, rather than large, busnesses. 24/ As firms grow ever larger, they may lose organizational flexibility which some believe is essential to the innovative process. Conglomerate mergers may thus serve to stifle the climate for innovation. 25/

2.3 The Cumulative Effects of Large Conglomerate Mergers May Be Substantial

Although conglomerate mergers among large enterprises may, on average, have relatively few net economic benefits or detriments for the firms involved, the cumulative impact of conglomerate mergers on society may be significant. The next section of this report will detail those effects as they specifically relate to small business; this section will summarize the effect of conglomerate acquisitions on society as a whole.

22/ See, e.g., J.K. Galbraith, The New Industrial State 58-59 (1959).

23/ P. Drucker, The Age of Discontinuity (1968).

24/ J. Jewkes, D. Sawers & R. Stillermann, The Sources of Innovation (1958 rev. ed. 1969)

25/ See J.M. Blair, Economic Concentration: Structure, Behavior and Public Policy 199-254 (1972). Cf. United States v. Continental Can Co., 378 U.S. 441 (1964). In that case the Court noted that an arguably conglomerate merger between glass and metal container manufacturers could reduce the innovative vigor of the combined firm. Glass and metal technologies were distinct, but competed for some common business. The Court expressed the belief that in a combined firm one of the technologies might be de-emphasized when interfirm competition could have otherwise resulted.

Perhaps the most overt effect of mergers and acquisitions among America's largest businesses is the contribution they make toward the increasing concentration of economic power in relatively fewer and fewer corporations. One of the fundamental principles underlying our society's approach toward economic organization, repeatedly articulated by Congress and the courts in developing antitrust policy, is the encouragement of a diversity of voices and a decentralization of economic power. Large business organizations, however, are seen by some as inherently at odds with these basic precepts of a democratic society: because they employ many individuals, and purchase and produce much of our nation's economic output, large enterprises may have undue influence on the political affairs of the nation. 26/

With a broad community of interests dependent on their financial well-being, the largest corporations are in a position to encourage a favorable response from public officials. Similarly, because of their ability to marshal both economic resources and the time of employees, large firms may be in a position to have a disproportionate voice in the shaping of the political debate over various issues of public importance. This latter role of the corporation in American society was recently brought home by the Supreme Court's decision in First National Bank of Boston v. Belloti, 27/ which upheld the right of business enterprises to spend funds without government restriction to advocate positions on a wide variety of issues.

Thus, to the extent that conglomerate mergers decrease the number of independent decision centers in the business community without enhancing productivity, they contribute to a needless undercutting of basic American values. In addition, conglomerate mergers cumulatively may cause economic and competitive harms as well.

First, conglomerate mergers may divert corporate financial resources or loan capacity from investment in new productive facilities. Instead of taking the relatively risky, but societally beneficial, step of creating new capacity for the production of goods or services, firms may take the expedient step of "growth by acquisition," a process that simply serves

---

26/ See, e.g., C. Lindblom, Politics and Markets 344-356 (1977).

27/ 435 U.S. 765 (1978).

to transfer wealth from the purchasing corporation (and its shareholders) to the shareholders of the target enterprise. Moreover, when banks lend funds to finance a takeover, resources available for internal expansion by businesses, including small business, are diminished. Where this process involves a "hostile" takeover, additional investable funds may be dissipated in the form of payments to lawyers and public relations agencies as the suitor and target firm battle it out in every forum except that of the market place. Indeed, it is estimated that one recent highly contested acquisition cost upwards of $15 million in direct outlays. 28/ Needless to say, corporate efficiency can only suffer as the attention of senior managers is diverted from the normal process of running a business so they can participate in the battle for control of the target firm.

The cumulative effect of conglomerate mergers may do more than merely decrease investment in new productive facilities; it may decrease competition throughout the economy as firms choose to buy a "presence" in an attractive market by acquisition of an existing firm, rather than through creation of a new competitor. As long as companies continue to have the opportunity to diversify through acquisition, including acquisition of relatively dominant firms, they cannot be faulted for avoiding the more procompetitive means of diversification, de novo entry or purchase of a firm with a relatively small market share.

Finally, conglomerate mergers facilitate the emergence of "mutual forbearance" on the part of major firms. As firms increasingly operate in markets common to each other, they can develop a community of interests which discourages aggressive competition. For example, a firm with a competitive advantage in one market may forego exercising that advantage because a competitor in that market is a conglomerate operating also in another market in which the first firm is competitively weak. The firm may fear that to compete in the first market will invite retaliation in the second, imposing costs counterbalancing any expected gains in the first. 29/ The likelihood of the emergence of this "live and let live" philosophy may be enhanced where these overlaps occur in concentrated markets in which the conglomerates involved control leading firms.

28/ Wall Street Journal, April 3, 1979, at 1 col. 6.

29/ See Staff of the Antitrust Subcomm. House Comm. on the Judiciary, 92nd Cong., 2nd. Sess., Report on Investigation of Conglomerate Corporations 60-67 (Comm. Print 1971).

§ 3 The Effects of Conglomerate Mergers on Small Businesses

This section explores the effects of conglomeration on small business. Acquisition of a firm by a large corporation may have a variety of effects on small business. It can affect small business in the markets in which the acquired firm operates, the acquired firm's relationships to its small business suppliers and customers, and the acquired firm's relationship with the community in which it functions. Additionally, even if individual mergers do not produce significant impacts, the effect of many mergers, taken together, may be significant.

At the outset it should be noted that, as a direct consequence of disproportionately large growth by large corporations, the share of productive wealth held by small business has declined. In 1960, small and medium size corporations controlled 50 percent of the nation's manufacturing assets. Notwithstanding a substantial increase in the number of small business firms, by 1976 the relevant share dwindled to 30 percent. 30/ This decline is not just the product of natural forces encouraging accelerated growth by large firms. Artificial barriers seemingly restrain small business growth. 31/ Thus, in examining the effects of conglomerate mergers upon small business, it is important to note the ways in which conglomerate mergers may exacerbate those problems which small businesses believe hamper their development.

3.1 Competitive Effects on Markets in Which the Conglomerate Operates

The chief threat to small business rivals resulting from the acquisition of a competitor by a large enterprise is that the transaction will "entrench" the competitor's market position or enable the acquired firm to "invest" in short-run predatory conduct for the purpose of achieving the benefits of a dominant position thereafter. Moreover, the purchase of a firm by a mu[illegible]-line conglomerate may enhance the firm's opportunity to use business reciprocity, tie-in sales, or predatory pricing tactics to gain unwarranted sales and profits at the expense of smaller rivals. 32/ A conglomerate merger which may enlarge a disparity

---

30/ See Subcomm. on Antitrust, Consumers and Employment of the House Comm. on Small Business, Future of Small Business in America, H.R. Rep. No. 95-1810, 95th Cong., 2nd Sess. 41-62 (1978).

31/ See Id., at 20-27.

32/ See, e.g., V. Mund & R. Wolf, Industrial Organization and Public Policy 142-63 (1971).

in financial resources between a conglomerate firm and its market rivals may also create a fear that the newly enriched competitor may use its resources to retaliate against any company instituting a price move, and thus, either discourage smaller rivals from aggressively competing 33/ or encourage them to obtain similar resources by seeking out a comparably sized merger partner, further accelerating the loss of small businesses. 34/

The threat of anticompetitive entrenchment is especially great when a conglomerate firm acquires a dominant or near-dominant firm in a concentrated industry. In some cases the conglomerate may be able to transfer its economic power to a new line of commerce. It may be able to use earnings derived in other markets to subsidize its operations in the new market, or vice-versa, to enable it to sell its products at a substantial reduction in price and profits to gain an increase in its market share at the expense of firms which are unable to adopt similar pricing strategies because they lack a second income stream to support production at reduced profit levels. 35/ This possibility particularly affects the one-market small business.

Some conglomerate firms have extensively and intensively advertised products which are obtained in a merger. 36/ This advertising may increase the sale of the product at the expense of firms, especially small firms, which lack the financial wherewithal to mount such marketing campaigns. While there is not a consensus on this matter, some economists believe that this advertising is anticompetitive in that it creates a barrier to the growth or entry of competitors. 37/ If large scale advertising is, as other economists suggest, a proper form of competition in distribution, 38/ the adverse effects on small business that may result cannot theoretically be considered "anticompetitive." Nevertheless, it would appear that, to

---

33/ See, e.g., FTC v. Procter & Gamble Co., 386 U.S. 568, 578 (1967).

34/ See United States v. Continental Can Co., 378 U.S. 441, 465 (1964); United States v. Wilson Sporting Goods Co., 288 F. Supp. 543, 558 (N.D. Ill. 1968).

35/ See, e.g., P. Steiner, Mergers 233-38 (1977).

36/ See FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).

37/ See H.M. Mann, Advertising, Concentration and Profitability: The State of the Knowledge and Directions for Public Policy, in H. Goldschmid, H.M. Mann & J.F. Weston, Industrial Concentration: The New Learning 137 (1974).

38/ See Y. Brozen, Entry Barriers: Advertising and Product Differentiation, in H. Goldschmid, H.M. Mann & J.F. Weston, Industrial Concentration: The New Learning 114 (1974).

the extent that the only "advantage" derived from a conglomerate acquisition of a leading firm is an increased advertising budget, the transaction may injure small businesses without significant benefits to the public.

3.2 Effects on Customers and Suppliers of a Conglomerate

While an alteration in an acquired corporation's operational practices does not always ensue following its acquisition by a conglomerate, changes in marketing strategies, pricing practices and credit extension policies have sometimes followed a merger. 39/ These operational modifications may disrupt long established business relationships. Small business firms are particularly affected by such changes, since many of these firms are engaged in the distributional process and must purchase products from these acquired manufacturers for resale at the wholesale or retail level. 40/

Of particular concern to small business may be the conglomerate establishment of a centralized purchasing system. The conglomerate may attempt to consolidate its buying power by having all supplies purchased at a central location. It may choose to eliminate existing arrangements with local small business in favor of acquiring goods from a larger company. The consolidation of purchasing power may or may not represent a savings to the firm, but it often creates severe losses for the affected small businesses. 41/

Small firms are especially vulnerable to the adverse consequences of changes in existing business practices, since even transitory costs generated by such changes can cause severe cash flow difficulties and disproportionately affect the small business firm's often small profit.

39/ *See, e.g.*, *Hearings before the Small Business Administration, In re Proposed Takeover of Carrier Corp. by United Technologies Corp.* (Nov. 2 and Dec. 1, 1978).

40/ Recent statistics show that small businesses generated 70 percent of the nation's wholesaling and 72 percent of the nation's retailing business. *Future of Small Business in America, Part 1, Hearings before the Subcomm. on Antitrust, Consumers and Employment of the House Comm. on Small Business*, 95th Cong., 2d. Sess. 65 (1978).

41/ *See* *Hearings before the Small Business Administration*, *supra* note 39 at 46-57 (Dec. 1, 1978) (statement of Richard Oliker).

3.3 Effects on the Conglomerate's Community

A conglomerate merger may decrease the commitment of an acquired firm to the financial and civic health of its local community. When corporate decision-making power is transferred and consolidated in distant cities, local interests and needs may become increasingly less relevant to corporate management. Local service industries may, in particular, find their business diminished when the corporation chooses to rely on businesses in the cities where its headquarters are located to fulfill the financial, legal, accounting and other needs of the business. 42/

Additionally, because a large corporation often determines the fate of a particular plant by reference to broad corporate goals, it may close an acquired plant for not achieving these goals, though the business remains viable. Whereas a locally oriented enterprise might make a special effort to seek improved methods of operation to allow it to remain in business and thus preserve the jobs of local managers and employees, the large corporation may believe that its management talent and available funds might more readily be invested elsewhere in its conglomerate structure and simply shut the business down. 43/

A plant closure directly affects those small businesses that dealt with the plant directly. Additionally, a plant closure may affect the economic vitality of a community, which may affect small businesses through a "ripple" effect.

3.4 Effects on Government Regulation

Small business persons believe that much of the current governmental regulation handicaps their firms' performance. The cost of providing information required by regulators

---

42/ *See, e.g.*, Fishbein, *Conglomerate Mergers and Economic Concentration*, 62 Yale Rev. 507 (1973); Mueller, *Mergers' Impact on the Community*, 78 Am. Fed. 14 (June 1978); Federal Trade Commission, Economic Report on Corporate Mergers 473-77 (1969).

43/ *See, e.g.*, *Mergers and Industrial Concentration, Hearings before the Subcomm. on Antitrust and Monopoly of the Senate Comm. of the Judiciary*, 95th Cong., 2d Sess. 3-6, 171-184 (1978) (statements of E.F. Kelly and Walter Adams).

is relatively fixed: regardless of the size of a firm queried, a substantially equivalent effort may be required to answer most government questionaires. This means the proportionate cost of conforming to regulatory informational demands is inversely related to the size of the responding firm. Moreover, small firms are often unable to hire regulatory specialists to monitor, communicate with, or challenge regulatory authorities, and thus must suffer the consequences of an increased cost for last-second compliance with regulations. Larger enterprises thus gain a substantial, if artificial, competitive advantage where regulation exists. 44/

Regulatory involvement is growing. The number of rules promulgated by agencies, as recorded in the Federal Register, has increased substantially. The conglomerate merger wave may contribute to this growth. While many government regulatory programs represent much-needed efforts to protect the public health and safety, many citizens also appear to believe, however reluctantly, that "big government" is a necessary countervailing power to "big business." Consequently, calls for government regulation over and above that which might be required in a more decentralized, more competitive economy, may receive the support of legislators. 45/ To the extent that conglomerate mergers contribute to this perceived need for countervailing governmental intervention, the continued occurance of such mergers will likely lead to further regulation. Ironically, of course, such regulation may impose relatively greater costs on small business, creating further difficulties for their efforts to prosper.

44/ See, e.g., Future of Small Business in America, Part 1, Hearings before the Subcomm. on Antitrust, Consumers and Employment of the House Comm. on Small Business, 95th Cong., 2d Sess. 31-38, 90-98 (1978) (statements of James D. McKevitt and John Lewis).

45/ See, e.g., United States v. Falstaff Brewing Co., 410 U.S. 526, 543 (1973) (Douglas J. concurring); Blake Conglomerate Mergers and the Antitrust Laws, 73 Colum. L. Rev. 555, 570-79 (1973).

§ 4 The Prospect for Control of Conglomerate Mergers Under Existing Antitrust Laws

The principal legal constraint on mergers, Section 7 of the Clayton Act, has, for a number of reasons, proved an unsatisfactory tool for controlling conglomerate mergers. Its ineffectiveness is best illustrated by the fact that since 1973, in a period of heightened conglomerate merger activity, there has not been a successfully litigated conglomerate merger challenge; both the Antitrust Division and the Federal Trade Commission have lost approximately twelve merger cases based on conglomerate theories from 1973 through 1978. 46/

The chief defect of present law is its narrow focus on anticompetitive effects in particular markets. Judicial decisions in the early 1960's made clear that the statute can effectively scrutinize horizontal or vertical mergers because those mergers have a direct potential for lessening competition in a given line of commerce. 47/ However, conglomerate mergers, for the most part, have escaped enforcement efforts because they often do not pose immediate competitive threats to a given market. Government attempts to expand the scope of the act by challenging mergers because of their effect on aggregate or economy-wide concentration have been rejected. 48/

46/ See, e.g., Bauer, Challenging Conglomerate Mergers Under the Clayton Act: Today's Law and Tomorrow's Legislation, 58 B.U.L. Rev. 199-202 (1978) (listing eleven unsuccessful conglomerate challenges through early 1978).

47/ E.g., Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

48/ United States v. Northwest Industries, Inc., 301 F. Supp. 1066, 1096 (N.D. Ill. 1969); United States v. International Telephone & Telegraph Corp., 306 F. Supp. 766, 796-97 (D. Conn. 1969).

Although the courts have accepted certain of the competitive theories advanced by antitrust agencies to attack particular conglomerate mergers, the requisite proof is very difficult.

For instance in "actual" potential competition cases the plaintiff may be required to establish that the potential entrant subjectively intended alternative entry into the market. 49/ Thus, it may not be sufficient to establish the objective fact that alternative means of entry were feasible. Similarly, in cases where it is alleged the acquiring firm was a procompetitive force because it was perceived as a potential entrant, the courts may require evidence that existing competitors actually modified their conduct because of its presence on the fringe of the market. 50/ Further, the requirement that a potential entrant be one of only a few such entrants 51/ limits the effectiveness of the theory with respect to purely conglomerate mergers.

Courts have also recognized that a conglomerate merger may entrench a leading firm. The courts, however, have required fairly specific proof of such an entrenching effect before finding a violation of Section 7. Courts have refused to apply the theory where the acquired firm was not dominant in its market 52/ or where the argued entrenching effect was not based upon a close complementary relationship between the products sold by the two firms. 53/

49/ See FTC v. Atlantic Richfield Co., 549 F.2d 289, 296-97 (4th Cir. 1977); United States v. Falstaff Brewing Corp., 410 U.S. 526, 532-36, 563-70 (1973).

50/ See United States v. Falstaff Brewing Corp., supra note 49, at 533-34.

51/ See United States v. Marine Bancorporation Inc., 418 U.S. 602, 623-25 (1974). See also Id., at 628 n.32 (citing J. Bain, Industrial Organization 8 (2d ed. 1968)).

52/ See Butler Aviation Co. v. CAB, 389 F.2d 517, 519-21 (2d Cir. 1968).

53/ See United States v. Black & Decker Mfg. Co., 430 F. Supp. 729 (D. Md. 1976).

An increased opportunity for anticompetitive reciprocity has been recognized as a possible harmful effect of certain conglomerate mergers. As with the other conglomerate merger theories, the focus is on specific anticompetitive effects in particular economic markets. Thus, the mere possibility of some increased opportunity for reciprocity has not been generally accepted as a basis for prohibiting the typical conglomerate merger. 54/

Finally, even when particular anticompetitive effects can be demonstrated, the parties to the merger may simply decide to divest a portion of their assets to remedy the specific anticompetitive problem, often leaving them free to combine the bulk of their assets.

§5 Possible Legislative Remedies

On the basis of the evidence developed over the past decade, it is fair to conclude that mergers among this nation's largest business enterprises, particularly those that are conglomerate in nature, on an average contribute little to the enhancement of efficiency, productivity, and competition. At the same time, these transactions, by their very nature, serve to enhance the aggregate concentration of economic power in the hands of fewer and fewer large enterprises while removing from the business community independent voices for innovation, competition, and political expression.

Most importantly, merger and acquisition activity by the largest businesses carries with it a significant potential for harm to competition in general and to small business in particular. Acquisitions of dominant firms by firms with substantial resources may serve to entrench those firms and to finance predatory behavior that might not otherwise have been possible. Internalization of procurement and supply functions within a conglomerate may eliminate the acquired firm as either a supplier or customer of small businesses, as headquarters officials in a distant city find it administratively convenient to deal directly with a fewer number of larger enterprises. In some instances, where the acquired firm is a major factor in the local economy, the result may be the long-run impairment of the community's business environment.

54/ See Liebeler, The Emperor's New Clothes -- Why is Reciprocity Anti-Competitive?, 44 St. John's L. Rev. 545 (spec. ed. 1970).

In light of these considerations and those outlined elsewhere in this report, we believe that large conglomerate mergers should be subject to rigorous scrutiny under the merger laws. Nevertheless, we also believe that an outright ban on the largest mergers would be unwise. In specific instances a conglomerate merger may enhance efficiency by, for example, permitting a combining of a distribution system of non-competitive products, or encouraging aggressive competition by infusing capital into a firm overshadowed by financially larger rivals. Consequently, a merger policy which forbade a takeover in these instances would serve to reduce possible competition advantages in a particular market for the purpose of maintaining a more societally optimal business structure overall.

We believe, however, that the choice between adoption of effective conglomerate merger legislation that would enhance competition and the role of small business, and the continued use of mergers and acquisitions as a part of the process by which capital is transferred among businesses to promote the efficient use of resources, is a choice that need not be made. Rather, a well-crafted legislative response can prevent those mergers least likely to create benefits and most likely to contribute to harmful competitive and societal effects, while permitting transactions that are likely to be in the public interest.

With these considerations in mind, we recommend passage of legislation that would shift the burden of proving the lawfulness of specified classes of large-scale mergers. These should include mergers that combine large firms so as to create exceptionally large aggregations of assets and revenues, and acquisitions by large firms of leading firms in concentrated markets. The presumption of unlawfulness, however, should be rebutable by a showing of appropriate public benefits to be derived from particular transactions.

Such legislation would be effective; it would deter ab initio efforts to consolidate large and dominant firms by defining restricted classes of transactions with sufficient specificity. The energy and resources thus freed could be directed toward other more desirable forms of growth such as internal expansion and de novo entry into new markets. The legislation would be flexible; firms believing that their prospective merger would enhance the economic well-being of society could make a showing of these benefits, and, if successful, they could consummate the transaction.

Legislation based on this approach would not be over-inclusive. Affecting only large mergers, such a statute would leave most mergers subject simply to present antitrust provisions. A ready market for the sale of small businesses would thus be retained as an incentive for entrepreneurs to invest, since they would be able to recover their investment of time and money if they chose to retire or change fields. Conversely, adoption of restrictions on the acquisition of large and dominant firms by giant corporations should not lead to a proportionate rise in acquisitions of smaller firms. The transactions costs associated with locating and purchasing an appropriate "target", and the costs that arise fom assimilating one firm into another, are multiplied significantly when several firms are acquired -- rather than one -- even if the total assets involved are the same.

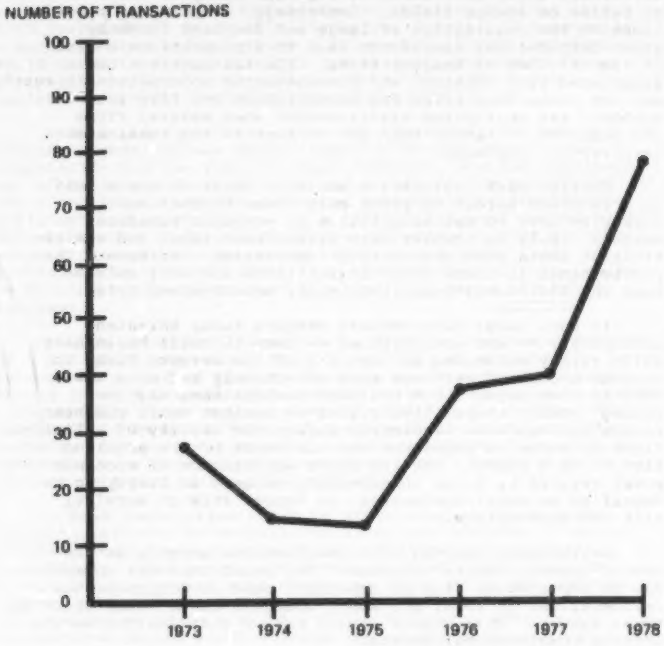
Lastly, such legislation would be fair: it would hold to a reversed burden of proof only those mergers most likely to have no net competitive or economic benefits, mergers likely to involve both significant legal and administrative costs even absent this legislation. Moreover, the participants in these large acquisitions are well able to bear any additional costs that might nevertheless arise.

In sum, large conglomerate mergers today threaten unnecessary -- and uncontrolled -- harm to small businesses. While rarely enhancing the ability of the merging firms to produce goods and services more effectively and at a lower cost to consumers, these business combinations may encourage unfair competitive practices against small business rivals and may also needlessly damage the ability of efficient firms to serve as suppliers and customers of the acquired firm. As a result, the immediate aggregation of economic power created by large conglomerate mergers is likely to be magnified as small businesses, no longer able to survive, exit the marketplace.

Legislation dealing with conglomerate mergers is presently pending before Congress. The small business community can be expected to play an important role in Congressional deliberations on them, for small business has a vital stake in these issues. This report should make a contribution to the ensuing Congressional debate.

CHART A

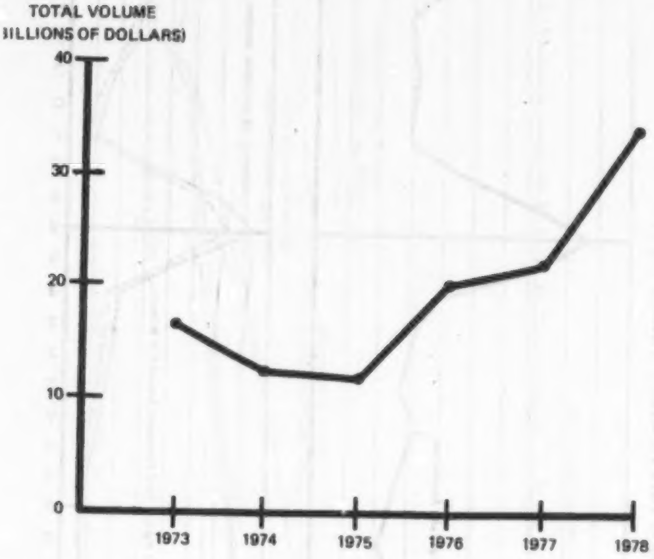
NUMBER OF CORPORATE MERGERS AND ACQUISITIONS VALUED AT $100 MILLION OR MORE



SOURCE: W. T. Grimm & Co.

NOTE: Data include transactions announced during year stated but cancelled after end of that calendar year.

CHART B
TOTAL VALUE OF ANNOUNCED CORPORATE MERGERS AND ACQUISITIONS

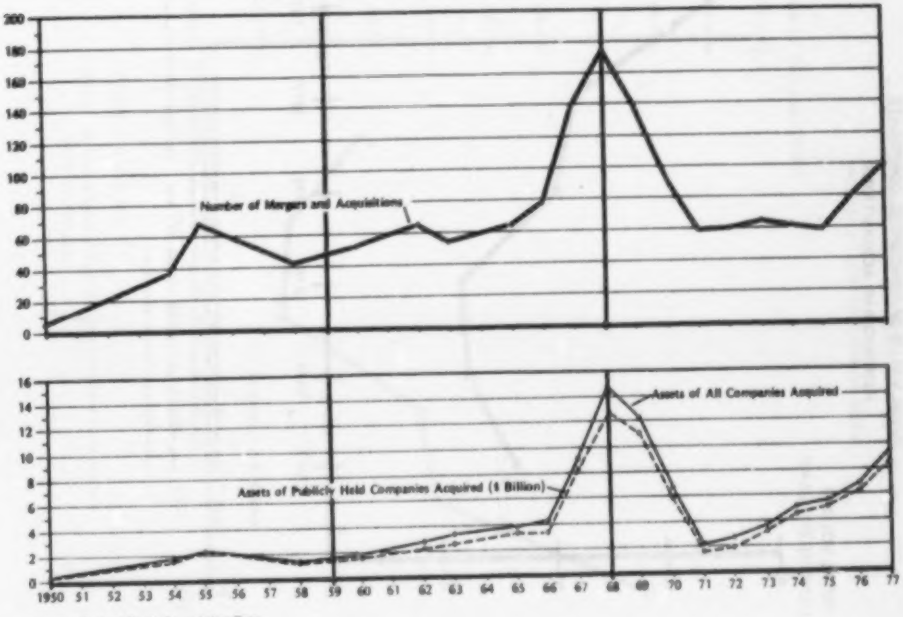


SOURCE: W. T. Grimm & Co.

NOTE: Data include only transactions for which dollar value was publicly announced. W. T. Grimm has indicated that these constitute virtually all transactions of any significant size, since all publicly held firms must announce dollar value. Total value refers to the value of cash and securities offered by the purchaser.

CHART C

MERGERS AND ACQUISITIONS OF MANUFACTURING AND MINING FIRMS OF OVER $10 MILLION IN ASSETS, 1950-1977

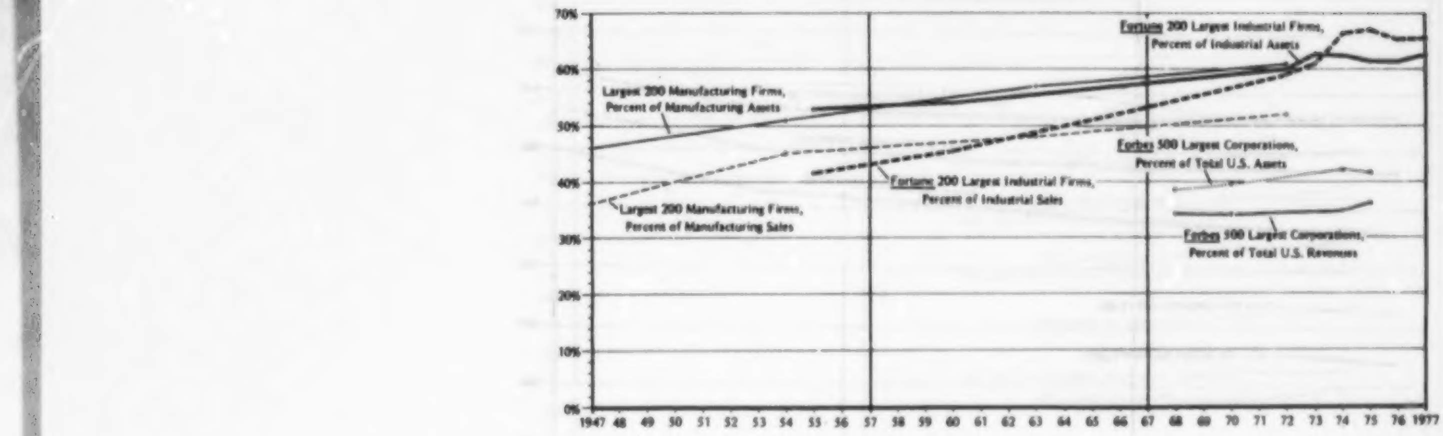


Source: Federal Trade Commission Data.

CHART C

CHART D

TRENDS IN AGGREGATE CONCENTRATION, BY VARIOUS MEASURES



Source: Justice Department Tables Based on Data from Various Sources.

CHART D

CHART E

SHARE OF VALUE ADDED ACCOUNTED FOR BY THE 50, 100, 200, 500, AND 1,000 LARGEST MANUFACTURING FIRMS

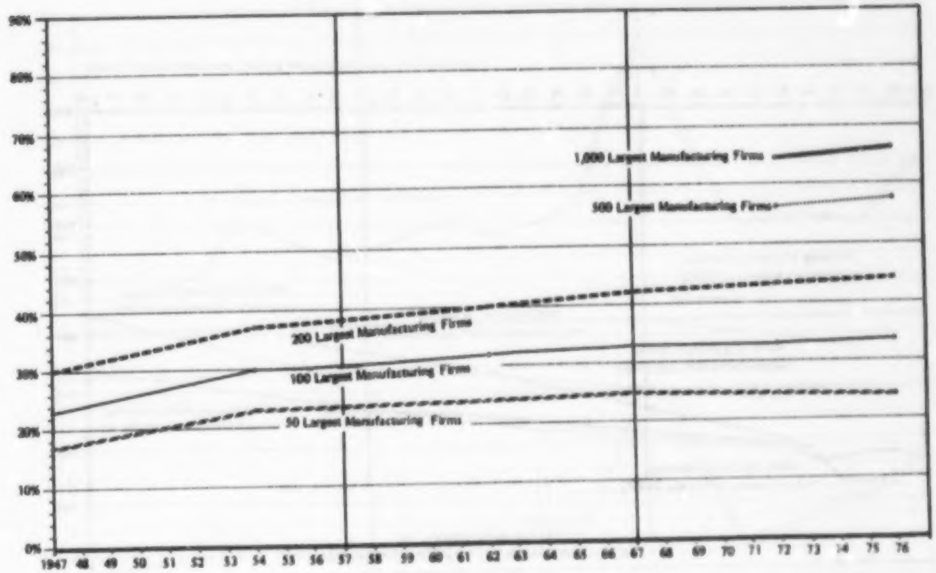
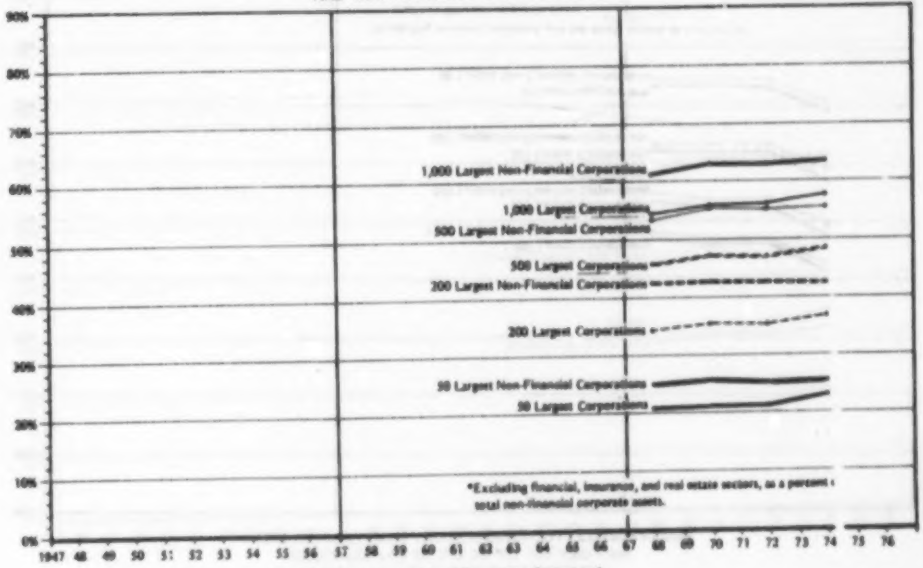


CHART F, PAGE 1

PERCENT OF TOTAL CORPORATE ASSESTS AND RECEIPTS ACCOUNTED FOR BY THE LARGEST CORPORATIONS, BY SECTOR:

PERCENT OF TOTAL CORPORATE ASSESTS HELD BY THE 50, 200, 500, AND 1,000 LARGEST CORPORATIONS AND NON-FINANCIAL* CORPORATIONS

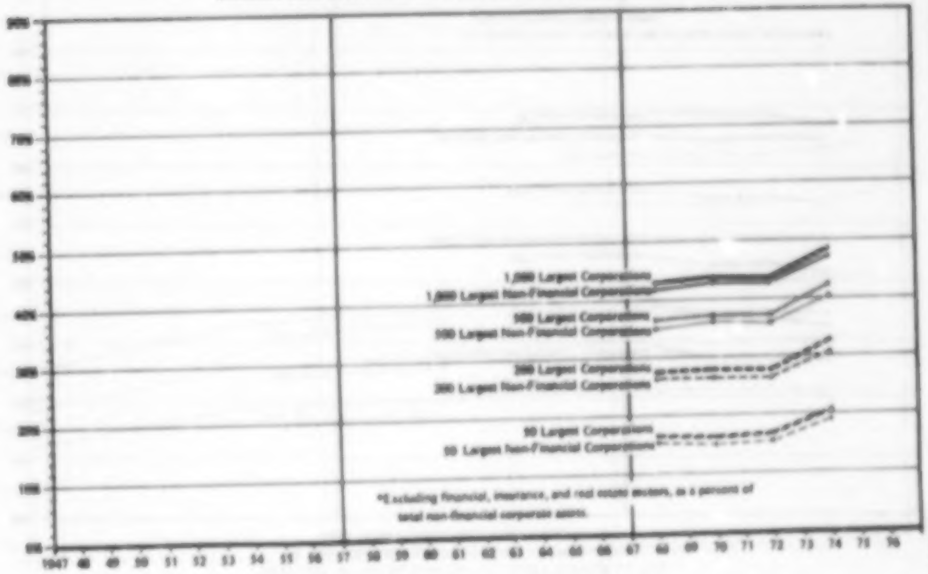


*Excluding financial, insurance, and real estate sectors, as a percent of total non-financial corporate assets.

SOURCE: Internal Revenue Service, Statistics of Income, Corporation Income Tax Returns, and non-published IRS tabulations.

CHART F, PAGE 2

PERCENT OF TOTAL CORPORATE RECEIPTS ACCOUNTED FOR BY THE 50, 200, 500, AND 1,000 LARGEST CORPORATIONS AND NON-FINANCIAL* CORPORATIONS



*Excluding financial, insurance, and real estate sectors, as a percent of total non-financial corporate assets.

CHART F, PAGE 3

PERCENT OF TOTAL CORPORATE ASSESTS IN VARIOUS SECTORS ACCOUNTED FOR BY THE LARGEST 200 FIRMS IN EACH SECTOR

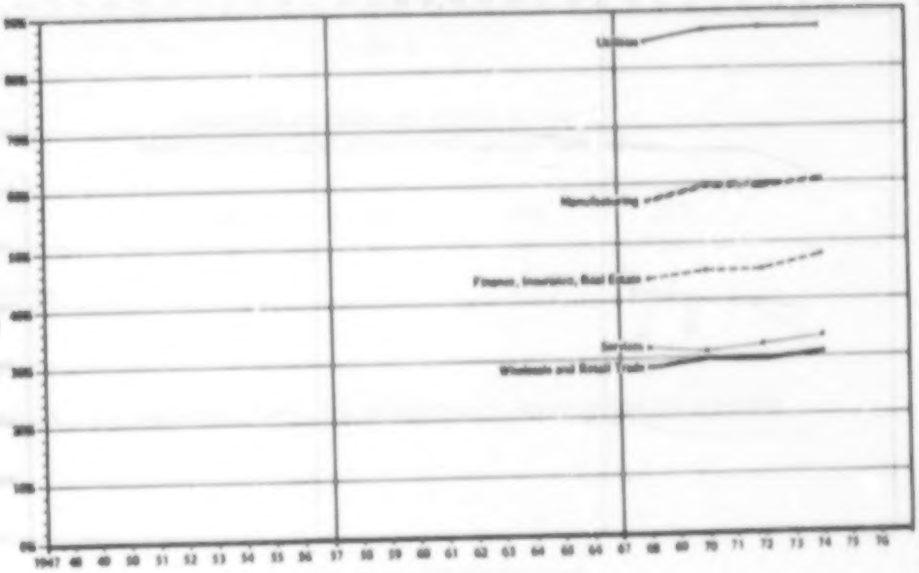


CHART F, PAGE 3

CHART F, PAGE 4

PERCENT OF TOTAL CORPORATE RECEIPTS IN VARIOUS SECTORS ACCOUNTED FOR BY THE LARGEST 200 FIRMS IN EACH SECTOR

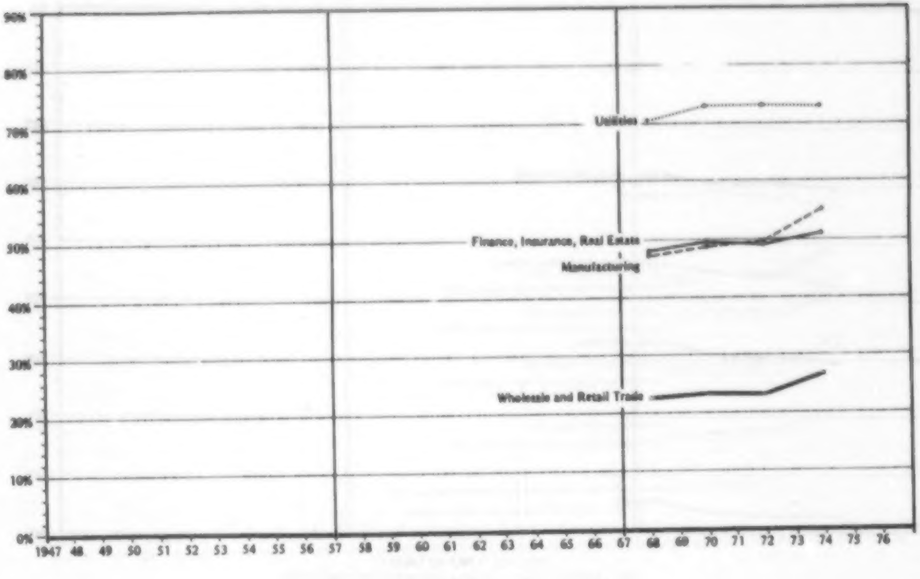


TABLE 1

PERCENTAGE OF SALES AND ASSETS OF ALL MANUFACTURING FIRMS ATTRIBUTABLE TO LARGEST 200

	1947	1954	1963	1972
Sales	36	45	48	52
Assets	46	51	57	61

Source: The Conference Board, The Relativity of Concentration Observations 3 (1977).

best copy available

TABLE 2

ASSETS OF THE 200 LARGEST FORTUNE INDUSTRIALS (RANKED ON THE BASIS OF SALES) COMPARED WITH TOTAL ASSETS OF ALL MANUFACTURING AND MINING CORPORATIONS FOR SELECTED YEARS

(In Millions of Dollars)

Year	Total Assets All Manufacturing And Mining Corporations	Fortune 200 Largest Assets	Fortune 200 As Percent Of Total
1955	$ 189,667	$ 100,688	53.1%
1960	265,030	144,541	54.5
1972	653,751	392,700	60.1
1973	718,768	449,118	62.5
1974	820,193	510,300	62.2
1975	896,639	553,200	61.7
1976	965,919	594,700	61.6
1977	1,050,205*	655,808	62.4

*Preliminary

Sources: Statistical Report on Mergers and Acquisitions, Federal Trade Commission Bureau of Economics, November 1977. Data for 1977 preliminary. Data for the years 1974-7 have been adjusted to compensate for changes i reporting procedures.

The Fortune Directory of the 500 Largest U. S. Industrial Corporations, ortune, May 8, 1978 and various editions of the Statistical Abstract of The United States. Companies included in the Fortune Directory of Individuals must have derived more than 50 percent of their sales from manufacturing and/or mining.

TABLE 3

TOTAL MANUFACTURING SALES COMPARED WITH THE FORTUNE 200 LARGEST INDUSTRIALS (RANKED ON THE BASIS OF SALES) FOR SELECTED YEARS

(In Billions of Dollars)

Year	Total Manufacturing Sales	Fortune 200 Largest	Fortune 200 As Percent Of Total
1955	$ 318	$ 132.8	41.8%
1960	371	166.0	44.7
1972	757	445.5	58.9
1973	875	532.9	60.9
1974	1,015	673.1	66.3
1975	1,047	702.9	67.1
1976	1,186	790.7	66.7
1977	1,335	889.7	66.6

Sources: 1955, U.S. Bureau of Economic Analysis, Business Statistics, 1973, thereafter, Survey of Current Business, January 1977. Taken from Statistical Abstract of The United States, 1977, p. 559 and Survey of Current Business, November 1978.

The Fortune Directory of the 500 Largest U.S. Industrial Corporations, Fortune, May 8, 1978 and various editions of the Statistical Abstract of The United States. Companies included in the Fortune directory of Industrials must have derived more than 50 percent of their sales from manufacturing and/or mining.

TABLE 4

TOTAL ASSETS, ALL ACTIVE CORPORATIONS*

COMPARED WITH FORBES 500 BIGGEST CORPORATIONS RANKED BY ASSETS

(In Millions of Dollars)

Year	All Active Corporations Total Assets	Forbes 500 Biggest Corporations Total Assets	Forbes 500 As a Percent Of All Industrial Divisions
1968	$2,215,625	$ 849,370	38.3%
1970	2,634,707	1,043,546	39.6
1974	4,016,467	1,697,699	42.3
1975	4,286,556	1,790,327	41.8

* Returns with and without net income.

Source: Dept. of the Treasury, Internal Revenue Service; Statistics of Income, Corporation Income Tax Returns, 1968, 1970, 1974. Data for 1975 preliminary. Taken from Statistical Abstract of the United States, 1971, 1973, 1977; Forbes, May 15 issues of 1969, 1971, 1975 and 1976.

TABLE 5

TOTAL RECEIPTS, ALL ACTIVE CORPORATIONS*

COMPARED WITH FORBES 500 BIGGEST CORPORATIONS RANKED BY REVENUES OR SALES

(In Millions of Dollars)

Year	All Active Corporations Total Receipts	Forbes 500 Biggest Corporations Revenues or Sales	Forbes 500 As a Percent Of All Industrial Divisions
1968	$1,507,786	$ 516,869	34.3%
1970	1,750,728	599,056	34.2
1974	3,089,701	1,071,366	34.7
1975	3,198,628	1,156,788	36.2

* Returns with and without net income.

Source: Dept. of the Treasury, Internal Revenue Service; Statistics of Income, Corporation Income Tax Returns, 1968, 1970, 1974. Data for 1975 preliminary. Taken from Statistical Abstract of the United States, 1971, 1973, 1977; Forbes, May 15 issues of 1969, 1971, 1975 and 1976.

TABLE 6

Share of Total Value Added by Manufacture Accounted for by the 50, 100, 150, 200, 500, and 1000 Largest Manufacturing Companies, For Selected Years

Year	50 Largest	100 Largest	150 Largest	200 Largest	500 Largest	1000 Largest
1947	17%	23%	27%	30%	NA	
1954	23	30	34	37		
1958	23	30	35	38		
1962	24	32	36	40		
1963	25	33	37	41		
1966	25	33	38	42		
1967	25	33	38	42		
1970	24	33	38	43		
1972	24.5	33.1	38.8	43.1	56.1%	64.4%
1976	24.4	33.5	39.5	44.0	57.6	66.1

NA: Not Available

Source: U. S. Department of Commerce, Bureau of the Census.

TABLE 7

ALL INDUSTRIES

Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1,000 Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	20.8%	21.4%	21.4%	23.1%
200 Largest	34.3	35.5	35.3	36.9
500 Largest	45.9	47.3	47.1	48.6
1,000 Largest	54.5	55.9	56.0	57.6
TOTAL RECEIPTS				
50 Largest	15.5%	15.1%	15.4%	19.2%
200 Largest	26.4	26.5	26.4	30.8
500 Largest	35.2	36.0	35.8	40.6
1,000 Largest	41.8 1/	42.8	42.6	47.3

1/ 1,001 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970, 1972 and 1974 and unpublished Internal Revenue Service data.

TABLE 8

ALL INDUSTRIES LESS FINANCE, INSURANCE, AND REAL ESTATE

Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1,000 Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	25.1%	25.9%	25.3%	25.7%
200 Largest	42.2	43.6	42.9	42.9
500 Largest	53.9	55.8	55.2	55.6
1,000 Largest	61.2	63.1	62.7	63.4
TOTAL RECEIPTS				
50 Largest	16.6%	16.2%	16.7%	20.9%
200 Largest	27.8	28.0	27.9	32.7
500 Largest	36.5	37.3	37.2	42.2
1,000 Largest	42.9 1/	43.9 1/	43.7	48.6

NA: Not Available

1/ 1,002 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970 and 1974 and unpublished Internal Revenue Service data.

TABLE 9

MANUFACTURING

Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1,000 Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	36.6%	37.7%	37.5%	38.0%
200 Largest	57.2	59.8	59.7	60.5
500 Largest	68.6	71.6	71.9	73.2
1,000 Largest	75.7	78.5	78.9	80.1
TOTAL RECEIPTS				
50 Largest	29.1%	28.9%	30.4%	36.5%
200 Largest	47.0	48.6	49.4	55.2
500 Largest	58.4	60.4	61.5	66.7
1,000 Largest	65.7 1/	67.8 2/	68.8	73.5

1/ 1,010 Companies
2/ 1,001 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970, 1972 and 1974 and unpublished Internal Revenue Service data.

TABLE 10

FINANCE, INSURANCE, AND REAL ESTATE

Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1,000 Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	28.4%	29.7%	29.5%	32.2%
200 Largest	43.8	45.0	45.1	47.8
500 Largest	55.0	56.0	56.5	59.2
1,000 Largest	63.0	64.0	64.8	67.4
TOTAL RECEIPTS				
50 Largest	32.3%	33.4%	32.4%	34.8%
200 Largest	47.9	49.4	48.2	51.2
500 Largest	57.8	59.3	58.5	61.7 1/
1,000 Largest	65.2 2/	66.4	66.1 3/	69.5 4/

1/ 502 Companies
2/ 1,007 Companies
3/ 1,001 Companies
4/ 1,004 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970, 1972 and 1974 and unpublished Internal Revenue Service data.

TABLE 11

SERVICES

Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1,000 Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	21.3%	20.1%	20.6%	20.2%
200 Largest	31.8	31.0	32.0	33.5
500 Largest	NA	38.4	39.8	41.2
1,000 Largest	NA	NA	NA	NA
TOTAL RECEIPTS				
50 Largest	13.8%	14.4%	12.3%	13.6%
200 Largest	22.1 1/	23.1 2/	20.1 3/	22.0 4/
500 Largest	NA	NA	NA	NA
1,000 Largest	NA	NA	NA	NA

NA: Not Available

1/ 227 Companies
2/ 224 Companies
3/ 205 Companies
4/ 208 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970, 1972 and 1974 and unpublished Internal Revenue Service data.

TABLE 12

WHOLESALE AND RETAIL TRADE

Percent of Total Corporate Assets and Receipts Accounted for by the 50, 200, 500 and 1,000 Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	20.0%	21.1%	20.6%	21.7%
200 Largest	28.2	30.0	29.4	30.9
500 Largest	33.6	35.6	35.2	37.1
1,060 Largest	37.9 1/	39.9	39.8	41.9 2/
TOTAL RECEIPTS				
50 Largest	14.9%	15.6%	15.2%	17.6%
200 Largest	22.5 3/	23.5	23.2	26.7
500 Largest	28.2 4/	29.3 5/	28.8 6/	32.8
1,000 Largest	NA	NA	NA	37.8 7/

NA: Not Available

1. 1,025 Companies
2/ 1,002 Companies
3/ 201 Companies
4/ 535 Companies
5/ 519 Companies
6/ 507 Companies
7/ 1,055 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970, 1972 and 1974 and unpublished Internal Revenue Service data.

TABLE 13

TRANSPORTATION, COMMUNICATION, AND ELECTRIC, GAS, AND SANITARY SERVICES

Percent of Total Corporate Assets and Receipts
Accounted for by the 50, 200, 500 and 1,000
Largest Corporations for Selected Years

	1968	1970	1972	1974
ASSETS				
50 Largest	57.9%	59.9%	60.4%	60.5%
200 Largest	84.7	86.5	86.7	86.8
500 Largest	91.8	92.9	93.4	93.4
1,000 Largest	NA	95.5	NA	NA
TOTAL RECEIPTS				
50 Largest	49.9%	51.9%	51.9%	51.0%
200 Largest	70.8	73.2	73.2	73.0
500 Largest	80.2 1/	82.3 2/	82.3	82.2 3/
1,000 Largest	NA	NA	NA	NA

NA: Not Available

1/ 530 Companies
2/ 533 Companies
3/ 512 Companies

Sources: Based on data from Internal Revenue Service Statistics of Income, Corporate Income Tax Returns, 1968, 1970, 1972 and 1974 and unpublished Internal Revenue Service data.

TABLE 14

Mergers in Manufacturing and Mining
(Large Companies)

	1947	1950	1954	1955	1958	1960	1962	1963	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
Number	--	5	37	67	42	51	65	54	64	76	138	174	138	91	59	60	64	62	59	81	99
Assets Acquired, Publicly held companies (billions $)	--	0.2	1.4	2.2	1.1	1.5	2.3	2.5	3.3	3.3	8.3	12.6	11.0	5.9	2.5	1.9	3.1	4.5	5.0	6.3	8.7
Assets Acquired, All large companies (billions $)	--	0.2	1.5	2.2	1.2	1.7	2.7	3.2	3.7	4.4	9.0	13.8	12.2	6.6	3.1	2.7	3.6	5.1	5.3	6.9	9.6

Source: Federal Trade Commission

TABLE 15

LARGE ACQUISITIONS* IN MANUFACTURING AND MINING BY FIRMS RANKED AMONG THE 200 LARGEST MANUFACTURING FIRMS IN 1975, BY YEAR, 1948-1977

(In Millions of Dollars)

Year	Value of Assets Acquired	Value of Assets Acquired in 1977 Dollars **
1948	$ 63.2	$ 159.1
1949	45.3	115.2
1950	20.0	50.3
1951	160.1	373.5
1952	195.0	445.1
1953	457.9	1,037.6
1954	919.9	2,074.0
1955	1,148.7	2,599.6
1956	1,246.5	2,779.4
1957	693.4	1,492.8
1958	682.1	1,429.5
1959	687.9	1,430.3
1960	789.4	1,615.3
1961	1,480.7	2,999.7
1962	1,205.6	2,415.0
1963	1,871.7	3,704.4
1964	1,075.7	2,101.5
1965	1,815.7	3,486.9
1966	1,929.5	3,603.1
1967	5,252.8	9,533.8
1968	7,717.1	13,440.9
1969	6,054.5	10,008.3
1970	3,260.2	5,087.8
1971	960.6	1,437.3
1972	739.1	1,070.5
1973	1,767.0	2,409.6
1974	1,874.6	2,303.7
1975	2,592.0	2,918.2
1976	2,809.1	2,990.3
1977	5,236.9***	5,236.9
TOTAL	$54,203.3	$90,349.6

Continued on next page

TABLE 15 (continued)

Total Assets Acquired 1948-1960 in Actual Dollars	$ 7,109.4
Total Assets of 200 Companies in 1960 in Actual Dollars	120,375.0
Total Assets Acquired as Percent of Total Assets	5.9%
Total Assets Acquired 1948-1977 in Actual Dollars	$ 54,203.3
Total Assets of 200 Companies in 1977 in Actual Dollars	662,234.0
Total Assets Acquired as Percent of Total Assets	8.2%
Total Assets Acquired in 1948-1960 in 1977 Dollars	$ 15,601.7
Total Assets of 200 Companies in 1960 in 1977 Dollars**	246,323.0
Total Assets Acquired as Percent of Total Assets	6.3%
Total Assets Acquired 1948-1977 in 1977 Dollars	$ 90,349.6
Total Assets of 200 Companies in 1977	662,234.0
Total Assets Acquired as Percent of Total Assets	13.6%

* Acquired firms with assets of $10 million or more.

** Adjusted to 1977 dollars on the basis of the Consumer Price Index.

*** Preliminary.

Note: Not included in the above tabulation are companies for which data were not publicly available. There were 164 such companies with assets of $5.2 billion for the period 1948-1976 (and an unknown number and amount in 1977), which were acquisitions by the 200 largest companies.

Sources: Statistical Report on Mergers and Acquisitions, Federal Trade Commission, Bureau of Economics, November 1977, Table 22. Data for 1977 preliminary.

Fortune Directory of the 500 Largest Industrial Corporations, Fortune, August 1961, May 15, 1976 and May 8, 1978.

APPENDIX DD.—STATEMENT SUBMITTED BY WILLIAM C. NORRIS, CHAIRMAN AND CEO, CONTROL DATA CORP.

8100-34th Avenue South
Mailing Address/Box 0
Minneapolis, Minnesota 55440

William C. Norris
Chairman of the Board &
Chief Executive Officer

CONTROL DATA
CORPORATION

March 26, 1980

Hon. Berkley Bedell, Chairman
Subcommittee on Antitrust and
Restraint of Trade Activities
Affecting Small Business
R-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Bedell:

In response to your letter of March 18th inviting the submission of a written statement of Control Data's philosophy on mergers, I am pleased to forward a copy of a recent talk on the subject. This talk entitled, "Irresponsible Mergers and Acquisitions", not only describes Control Data's philosophy and policies on mergers but the effects of mergers and recommends the basis for constructive legislation.

I look forward to reading the findings of the Subcommittee on this highly important subject.

Sincerely,

William C. Norris

William C. Norris

/kr
Enc.

DRAFT-WCN-3/4/80

F

IRRESPONSIBLE MERGERS & ACQUISITIONS

EXPERIENCE GAINED FROM TALKING ABOUT CORPORATE MERGERS, ESPECIALLY THE HOSTILE TAKEOVER VARIETY, HAS TAUGHT ME TO OPEN THE SUBJECT OF MERGERS BY CLARIFYING MY MOTIVES. THAT HELPS TO ALLAY THE DOUBTS OF SOME WHO MAY BE PUZZLED OVER: WHERE IS HE COMING FROM? WHAT'S IN IT FOR HIM? IS HE AFRAID THAT CONTROL DATA WILL BE THE TARGET OF A TAKEOVER?

THAT FEAR OF A TAKEOVER HAS NEVER KEPT ME AWAKE NIGHTS. ONE REASON IS THE NATURE OF CONTROL DATA'S BUSINESS. MANY BIG COMPANIES, NOTABLY G.E. AND RCA, EACH LOST MANY HUNDREDS OF MILLIONS OF DOLLARS PROVING THAT BIG COMPANIES NOT BASICALLY IN THE COMPUTER FIELD DIDN'T UNDERSTAND HOW TO SUCCEED IN IT. AND ANTITRUST LAWS PROTECTED US FROM A TAKEOVER ATTEMPT BY ANY LARGE COMPUTER COMPANY. THOSE FACTORS WERE ADEQUATE INSURANCE DURING THE YEARS WHEN CONTROL DATA WAS STRUGGLING TO ESTABLISH A UNIQUE AND EFFECTIVE LONG-TERM BUSINESS STRATEGY. AFTER THAT WAS ACHIEVED AND CONTROL DATA BEGAN TO PROSPER, WE DECIDED TO PUT IN PLACE CERTAIN POLICIES TO FURTHER PROTECT OUR EMPLOYEES, STOCKHOLDERS AND OTHER STAKEHOLDERS FROM VULNERABILITY TO INJURY FROM A HOSTILE TAKEOVER. I WILL TALK ABOUT THESE POLICIES LATER.

WHAT'S IN IT FOR ME IS SIMPLY THE SATISFACTION OF HELPING TO BRING ABOUT CONSTRUCTIVE CHANGE, AND THEN TO SEE CONTROL DATA AND OTHER ORGANIZATIONS ENJOY THE BENEFITS OF THAT CHANGE.

THE CHANGE I'M TALKING ABOUT IS LESSENING THE ECONOMIC AND SOCIAL TRAUMA, ESPECIALLY THE EFFECT ON JOBS, THAT RESULT FROM MERGERS. TO HELP EXPLAIN, I WILL QUOTE FROM A FORTUNE ARTICLE ON SENATOR KENNEDY'S PROPOSED SMALL BUSINESS PROTECTION ACT.

> "THE ANTI-MERGER BILL ACTUALLY HAS SOME SUPPORT FROM BUSINESS. THE MAJOR BUSINESS LOBBIES OPPOSE IT, OF COURSE, BUT SOME ZEALOUS BUSINESS CRITICS OF HOSTILE TAKEOVERS THINK MERGER RESTRICTIONS ARE A GOOD IDEA. ONE IS W. C. NORRIS, THE CHAIRMAN OF CONTROL DATA, WHO HAS AGREED TO TESTIFY ON BEHALF OF THE KENNEDY BILL AT JUDICIARY COMMITTEE HEARINGS. NORRIS HAS EVEN PUT OUT A SCORCHING THIRTY-SEVEN PAGE POSITION PAPER ON THE SUBJECT, COMPLAINING THAT TAKEOVERS VIOLATE THE "PERSONAL RIGHTS" OF MANAGERS OF TARGET COMPANIES, AND SUGGESTING THAT ACQUIRERS BE REQUIRED TO FILE "SOCIAL IMPACT" STATEMENTS WITH THE COURTS."

THE PARAGRAPH IS ACCEPTABLE TO ME IN SPITE OF SEVERAL INCENDIARY ADJECTIVES AND INCORRECTLY STATING THAT I TESTIFIED ON BEHALF OF THE KENNEDY BILL. BUT I REJECT THE MEANING INTENDED BY THE SENTENCE WITH RESPECT TO MY "COMPLAINING THAT TAKEOVERS VIOLATE THE PERSONAL RIGHTS OF MANAGERS". THE WORDING CLEARLY SUGGESTS THAT THE AUTHOR DOESN'T GIVE A DAMN ABOUT (FAT CAT) MANAGERS, AND HE THINKS MOST OTHER PEOPLE DON'T EITHER. THAT MIGHT BE CORRECT. BUT IT DOESN'T CONVINCE ME THAT MOST PEOPLE SHOULDN'T CARE. CONTROL DATA CERTAINLY CARES, JUST AS WE CARE ABOUT THE EMPLOYMENT RIGHTS OF THE DISADVANTAGED AND DISABLED.

IF PEOPLE REALLY CARED WHETHER OUR DISADVANTAGED HAD A DECENT JOB, THE UNEMPLOYMENT RATE OF DISADVANTAGED YOUTH WOULDN'T BE STAYING AT THE SHAMEFULLY HIGH LEVELS OF 30-35%. MOST ALSO DON'T CARE ENOUGH ABOUT OTHER VITAL ASPECTS OF UNEMPLOYMENT AND UNDEREMPLOYMENT. IF THEY DID, MORE WOULD BE DONE TO PROVIDE MEANINGFUL JOBS FOR THE MILLIONS OF DISABLED PERSONS. THESE PERSONS ARE CARED FOR BY GOVERNMENT SUPPORT, BUT OTHERWISE FORGOTTEN. THESE UNUSED HUMAN RESOURCES REPRESENT ECONOMIC AND SOCIAL WASTE THAT CONTRIBUTES TO OUR DEVASTATING INFLATION THAT IS ERODING OUR STANDARD OF LIVING. EVEN WORSE IS A LIFETIME OF SUFFERING THE INDIGNITIES OF BEING A BURDEN ON SOCIETY BY BEING DENIED THE BASIC HUMAN RIGHT OF A MEANINGFUL JOB.

CONTROL DATA IS WORKING VIGOROUSLY IN COOPERATIVE EFFORTS WITH A LARGE NUMBER OF OTHER ORGANIZATIONS TO DEVELOP MEANS OF INCREASING EMPLOYMENT OF THE DISADVANTAGED AND DISABLED. THIS TYPE OF ACTIVITY IS ESPECIALLY IMPORTANT, BECAUSE IT COUNTERS THE MOST SERIOUS ADVERSE EFFECT OF MERGERS, WHICH, AS EMPHASIZED LATER, IS THE DESTRUCTION OF JOB CREATING RESOURCES.

POSITION OF MERGERS

AT THIS POINT, HAVING CLARIFIED MY MOTIVES, I WILL GET BACK TO THE SUBJECT OF CORPORATE MERGERS BY NOTING THAT I AM NOT AGAINST ALL CORPORATE MERGERS. MERGERS OF SMALL COMPANIES CAN BE BENEFICIAL WHEN PRODUCTS AND SERVICES ARE COMPLEMENTARY, OR WHEN A COMPANY GETS INTO FINANCIAL DIFFICULTY OR IS UNABLE TO COPE WITH A SEVERE COMPETITIVE DISADANTAGE WITH ITS OWN RESOURCES. THERE MAY BE NO OTHER WAY TO PRESERVE ITS ASSETS OR TO AVOID A GROSS CUTBACK IN EMPLOYMENT. THERE ARE OTHER EXAMPLES OF CASES FOR MERITORIOUS MERGERS. BECAUSE OF VAST DIFFERENCES AMONG INDUSTRIES AND COMPANIES WITHIN AN INDUSTRY, EVALUATIONS MUST BE MADE ON A CASE-BY-CASE BASIS OF EACH MERGER ON ITS OWN MERITS. AS WILL BE DISCUSSED, THERE ARE PRACTICAL WAYS OF DOING THIS THAT PRESERVE THE PRESENT FREEDOM OF ACTION ENJOYED BY CORPORATIONS. IN ADDITION, IN DESIRABLE OR NECESSARY MERGERS, THOUGHTFUL AND COMPREHENSIVE PLANNING, ALONG

WITH PROPER IMPLEMENTATION, MINIMIZES THE IMPACT OF ADVERSE FACTORS.

GENERALLY SPEAKING, THEN, DESIRABLE MERGERS ARE MORE LIKELY TO BE FRIENDLY ONES. A CONTESTED TAKEOVER -- ONE PUBLICLY OPPOSED BY THE TARGET COMPANY'S BOARD -- IS A SIGNAL THAT ONE PARTY BELIEVES THE MERGER DOES NOT MAKE BUSINESS AND ECONOMIC SENSE. IT IS ALMOST IMPOSSIBLE TO HAVE THE NECESSARY ADVANCED PLANNING IN A HOTLY CONTESTED MERGERS. BUT EVEN FRIENDLY MERGERS CAN INVOLVE ADVERSE FACTORS.

ADVERSE FACTORS

WHAT ARE THE MOST IMPORTANT ADVERSE FACTORS? FIRST TO BE CONSIDERED IS EMPLOYEE TRAUMA, WHICH CAN START AT THE TOP OF A COMPANY BEING ACQUIRED AND EXTEND TO ALL OTHER WORKERS. MEMBERS OF TOP MANAGEMENT MAY SUFFER CAREER DAMAGE. YOUNGER EXECUTIVES MAY FIND CAREER PATHS LIMITED. OTHER WORKERS FACE ELIMINATION OF JOBS THROUGH CONSOLIDATIONS OF ADMINISTRATIVE AND OPERATING SEGMENTS.

VIRTUALLY EVERY YOUNG EXECUTIVE ASPIRES TO BE A MEMBER OF THE TOP MANAGEMENT BODY THAT IS RESPONSIBLE FOR BUSINESS STRATEGY AND THE MAIN INTERFACE BETWEEN THE ENTERPRISE AND ITS STAKEHOLDERS. THESE RESPONSIBILITIES MAINLY RESIDE IN TOP

PARENT COMPANY MANAGEMENT AND ARE THE BASIS OF A PROFOUND DIFFERENCE BETWEEN THE DUTIES AND RESPONSIBILITIES OF EXECUTIVES IN TOP MANAGEMENT OF THE PARENT COMPANY AND THOSE OF DIVISION OR SUBSIDIARY COMPANY MANAGEMENT. THIS DIFFERENCE IS WHAT THE ASPIRATIONS AND REWARDS OF TOP MANAGEMENT ARE ALL ABOUT. A POSITION IN TOP MANAGEMENT LOST THROUGH TAKEOVER IS OFTEN NOT RETRIEVABLE BECAUSE NOW FEWER OF THESE POSITIONS ARE AVAILABLE; AND IN LARGE COMPANIES, SUCH VACANCIES USUALLY ARE FILLED FROM WITHIN. FURTHER DOWN IN THE COMPANY RANKS, EXECUTIVES FIND NOT ONLY THEIR JOBS THREATENED OR CHANGED, BUT THEIR CAREER PATHS AS WELL.

AT OTHER LEVELS, JOB JEOPARDY IS FOREMOST IN EMPLOYEES' MINDS BECAUSE OF THE POTENTIAL ELIMINATION OF JOBS THROUGH CONSOLIDATIONS OF ADMINISTRATIVE AND OPERATIONAL FUNCTIONS. THIS IS UNNECESSARILY NERVE-RACKING IN HOSTILE TAKEOVERS BECAUSE OF LACK OF INFORMATION OR CREDIBILITY OF ASSURANCES ABOUT PLANS BY THE AGGRESSOR. THREE EXCERPTS FROM NEWSPAPER REPORTS DURING THE ATTEMPTED TAKEOVER OF GERBER BY ANDERSON CLAYTON ILLUSTRATE THIS POINT. FROM THE WALL STREET JOURNAL: "ONE CONCERN IS THAT IF IT WINS CONTROL OF GERBER, ANDERSON CLAYTON MIGHT CUT BACK ON GERBER'S 125-PERSON RESEARCH

OPERATION OR ON OTHER WHITE-COLLAR STAFFS, CONSLIDATING THEM WITH ITS OWN SIMILAR DEPARTMENTS ELSEWHERE". THE NEW YORK TIMES REPORTED: "THE TAKEOVER CAMPAIGN CREATED UNREST IN FREMONT, THOUGH ANDERSON CLAYTON INSISTED THROUGHOUT THAT IT HAD NO INTENTION OF MOVING JOBS FROM FREMONT. IN MAY, MAYOR BILLERBUB SAID: "I THINK YOU ARE SEEING A PANIC SITUATION IN TOWN RIGHT NOW. EVERYBODY IS CONCERNED BECAUSE THEY DON'T KNOW WHAT THE FUTURE WILL BRING". AFTER THE TAKOVER ATTEMPT FAILED, A NEWSPAPER HEADLINE READ: "GERBER EMPLOYEES GET OVER MERGER-ITIS FEAR".

EVEN IN CAREFULLY PLANNED VOLUNTARY MERGERS, THERE WILL BE SOME UNAVOIDABLE INJURY TO EMPLOYEE CAREERS AND INJUSTICES ARISING FROM THE PROCESS OF FORCING THE TWO ORGANIZATIONS TOGETHER.

IN ADDITION TO THE FINANCIAL RELIANCE ON THEIR EMPLOYERS, MANY EMPLOYEES HAVE STRONG COMMUNITY TIES. THE SEVERANCE OF THESE ROOTS BY AN ABRUPT TAKEOVER CANNOT BE MENDED BY FINDING A JOB IN ANOTHER PART OF THE COUNTRY, IF INDEED ONE CAN BE FOUND. THESE SOCIAL INJUSTICES ARE NOT ALWAYS ENTIRELY AVOIDABLE IN VOLUNTARY MERGERS, BUT THE CONSOLIDATING PROCESS CAN BE BETTER MANAGED TO MINIMIZE THEM.

THEN THERE ARE ALWAYS COMPANY COMMITMENTS TO EMPLOYEES, BOTH IMPLIED AND STATED, RELATING TO JOB RESPONSIBILITIES AND CAREER PATHS. EMPLOYEES EXPECT THEM TO BE FULFILLED, YET THEY UNDERSTAND THAT DUE TO COMPETITION, ADVERSE ECONOMIC CONDITIONS AND OTHER FACTORS NOT UNDER THE COMPLETE CONTROL OF MANAGEMENT, SOME MAY NOT BE FULLY MET. HOWEVER, WHEN THE MANAGEMENT OF ANOTHER COMPANY ENGAGES IN AN UNNECESSARY AND UNILATERAL TAKEOVER, IT CAUSES THE BREAKING OF MANY COMMITMENTS IN THE TARGET COMPANY THAT INFLICT COLD-BLOODED AND UNJUST SOCIAL INJURY. IT IS COLD BLOODED BECAUSE THE AGGRESSOR COMPANY HAS A CONFLICTING ARRAY OF COMMITMENTS TO ITS EMPLOYEES AND UNDERSTANDS WELL THE CONSEQUENCES OF BREAKING THEM. AND IT IS UNJUST BECAUSE IT COULD HAVE BEEN AVOIDED BY EITHER ACHIEVING THE TAKEOVER OBJECTIVES IN ANOTHER WAY OR BY RECOGNIZING THAT THE OBJECTIVE OF "I WANT IT AND THEREFORE I SHALL HAVE IT" IS NOT NECESSARILY A LEGITIMATE OBJECTIVE.

ECONOMIC TRAUMA

THE MOST SERIOUS ECONOMIC DAMAGE, YET THE LEAST UNDERSTOOD, RESULTS FROM THE DESTRUCTION OF JOB-CREATING RESOURCES. TECHNOLOGICAL INNOVATION IS THE WELLSPRING OF NEW JOBS. STUDIES HAVE SHOWN THAT SMALLER COMPANIES ARE THE BEST

INNOVATORS -- THEY ARE THE ONES THAT ORIGINATE A MAJORITY OF THE NEW PRODUCTS, PROCESSES AND SERVICES THAT PROVIDE THE NEW JOBS. IMMEDIATELY AFTER A TAKEOVER, AN INNOVATION-STIFLING PROCESS SETS IN.

AS CORPORATIONS RUSH TO PUT THEIR SPARE CASH INTO ACQUISITIONS, R&D AND NEW PLANTS SUFFER. FURTHERMORE, BECAUSE OF RISING COSTS OF R&D, THE INCREASED RISK OF LAUNCHING NEW PRODUCTS (BOTH BECAUSE OF RISING COSTS AND BECAUSE MANY OF THE EASIER THINGS HAVE ALREADY BEEN DONE) AND RELENTLESS STOCKHOLDER PRESSURE TO INCREASE EARNINGS, THE EMPHASIS TODAY IN MOST LARGE CORPORATIONS IS ON FURTHER IMPROVEMENT OF EXISTING PRODUCTS AND REDUCING LABOR CONTENT AND MATERIALS COST. THE DEVELOPMENT OF NEW PRODUCTS AND SERVICES SUFFERS IN THIS KIND OF ATMOSPHERE. THE BUREAUCRACY OF MANY LARGE ORGANIZATIONS TODAY PERCEIVE THE DEVELOPMENT OF NEW PRODUCTS AND SERVICES AS UNNECESSARILY RISKY. HENCE THEY ARE RESISTED AND THE MERGER ROUTE IS TAKEN TO INCREASE EARNINGS.

IN CONTRAST, THE ENVIRONMENT IN THE SMALLER ORGANIZATIONS IS ENTREPRENEURIAL, WHERE DEVELOPING IDEAS AND INVENTIONS INTO USEFUL PRODUCTS AND SERVICES, ASSOCIATED WITH HIGH RISK, IS A WAY OF LIFE. THIS MODE OF OPERATION IS INHERENT IN THE

BEGINNING OF THE BUSINESS AND CONTINUES BECAUSE THE BEST SECURITY FOR A SMALL COMPANY COMPETING WITH GIANT COMPANIES IS TO KEEP ADVANCING ITS TECHNOLOGY.

AFTER THE ACQUISITION OF A SMALLER COMPANY, THIS ENVIRONMENT CHANGES AS THE LARGER ACQUIRING ORGANIZATION BLANKETS THE OTHER WITH ITS BUREAUCRACY. THE SMALL COMPANY IS CONFRONTED WITH LAYER UPON LAYER OF PARENT COMPANY MANAGEMENT, WHICH OFTEN IS MORE ADEPT AT BLOCKING, THAN MAKING, DECISIONS, AND THE SUBSIDIARY COMPANY PROPOSALS FOR NEW PRODUCTS LANGUISH IN LIMBO FOR MONTHS. EVEN IF A NEW PRODUCT OR SERVICE IS FINALLY APPROVED, THERE IS THE GAUNTLET TO RUN IN THE LARGE ORGANIZATION OF THOSE -- AND THEY ARE IN THE MAJORITY -- WHO BELITTLE THE CHANCES OF SUCCESS OF NEW UNDERTAKINGS. ON TOP OF ALL THIS IS THE FOOT-DRAGGING, ROAD-BLOCKING ADMINISTRATIVE PROCESSES THAT HAVE TO BE CONTENDED WITH IN CARRYING OUT THE PROJECT.

THIS INNOVATION-STIFLING PROCESS IS COMPOUNDED BY EMPLOYEE TRAUMA FROM THE MERGER BECAUSE IT IS THE MORE CREATIVE EMPLOYEES WHO RESIGN FIRST. THE FINAL RESULT IS THE DISPERSAL AND ULTIMATE LOSS OF THE ENTREPRENEURIAL TEAM, THE MAJOR JOB-CREATING RESOURCE OF THE ACQUIRED COMPANY. AGAIN, AS

NOTED EARLIER. THIS IS ANOTHER EXAMPLE OF HUMAN AND ECONOMIC WASTE THAT IS FUELING INFLATION.

THIS VERY SERIOUS LOSS IS BORNE MORE IN THE SHORT TERM BY SOCIETY THAN THE STOCKHOLDERS OF THE SURVIVING CORPORATION. THROUGH CONSOLIDATION OF ADMINISTRATIVE AND OPERATING UNITS, PRODUCTIVITY IS INCREASED; I.E., OUTPUT IS INCREASED WITH FEWER WORKERS. IN OUR GRADUALLY WORSENING EMPLOYMENT ENVIRONMENT, THIS MEANS A NET LOSS OF JOBS FOR SOCIETY. THE DISPLACED WORKERS HAVE TO FIND EMPLOYMENT ELSEWHERE OR GO ON UNEMPLOYMENT COMPENSATION AND EVENTUALLY WELFARE. THEREFORE THE PROFITS FROM THE CONSOLIDATION ARE IN PART AT THE EXPENSE OF SOCIETY, BECAUSE IT IS SOCIETY THAT MUST EITHER PROVIDE NEW JOBS OR COMPENSATION FOR THOSE DISPLACED.

PERSONAL EXPERIENCES

THIS SCENARIO OF INNOVATION STIFLING AND DESTRUCTION OF JOB CREATING RESOURCES IS NOT BUILT ON THEORY OR SECOND-HAND INFORMATION. I HAVE LIVED IT BY BEING CAST IN ROLES ON BOTH SIDES -- ONCE WITH THE ACQUIRED COMPANY AND MANY TIMES AS THE ACQUIROR. I HASTEN TO ADD THAT ALL OF MY EXPERIENCE HAS BEEN WITH VOLUNTARY ACQUISITIONS -- NEVER WITH ONES THAT WERE CONTESTED.

MY EXPERIENCE AS PART OF AN ACQUIRED ORGANIZATION OCCURRED IN THE MERGER OF ENGINEERING RESEARCH ASSOCIATES INTO REMINGTON RAND IN 1952. ENGINEERING RESEARCH ASSOCIATES, ABBREVIATED TO ERA, WAS A HIGHLY INNOVATIVE, SMALL COMPANY THAT WAS STARTED IN 1946 BY A GROUP OF SCIENTISTS AND ENGINEERS, AND IT HAD ESTABLISHED MARKET LEADERSHIP IN LARGE-SCALE ELECTRONIC COMPUTERS FOR SCIENTIFIC AND ENGINEERING USE. GROWTH WAS EXTREMELY RAPID; AND BY 1952, THE COMPANY NEEDED ADDITIONAL FINANCING. IT WASN'T POSSIBLE TO ARRANGE, SO ENGINEERING RESEARCH WAS SOLD TO MUCH LARGER REMINGTON RAND.

WITHIN DAYS AFTER THE TAKEOVER, THE LARGE-COMPANY BUREAUCRACY BEGAN TO ENGULF ERA. THIS CAUSED A FEW OF THE MOST RUGGED AND THOSE WITH THE SHORTEST FUSES TO RESIGN. THOSE OF MORE TEMPERATE MAKEUP WAITED TO GIVE THE BUREAUCRACY A CHANCE. HOWEVER, DURING THE ENSUING FIVE YEARS, MANY OF THE BEST INNOVATORS LEFT. I LEFT IN 1957 TO START CONTROL DATA. THIS IS NOT MEANT TO BE CRITICAL OF REMINGTON RAND OR ANY OTHER LARGE COMPANY. IT IS SIMPLY THAT THE BUREAUCRACY IN LARGE COMPANIES DRIVES AWAY THE INNOVATORS. I HAVE SEEN IT HAPPEN AT CONTROL DATA AS WE GREW, AND I LEARNED THAT IT IS UNAVOIDABLE.

EXPERIENCE IN AN ACQUIRING COMPANY

BY 1957 THE INVESTMENT ENVIRONMENT HAD CHANGED, AND THE LAUNCHING OF CONTROL DATA, THE FIRST PUBLICLY FINANCED START-UP IN THE COMPUTER INDUSTRY, HELPED TO USHER IN THE WAVE OF SMALL HIGH TECHNOLOGY COMPANIES THAT WERE ABLE TO START UP IN THE 60'S BY SELLING LOW-PRICED STOCK TO THE PUBLIC. SURVIVAL IN THE BUSINESS OF DEVELOPING AND MARKETING LARGE COMPUTERS IN AN INDUSTRY ALREADY DOMINATED BY CORPORATE GIANTS REQUIRED CONTROL DATA TO GROW RAPIDLY. ACQUISITION OF OTHER SMALL COMPANIES WAS AN IMPORTANT PART OF THE STRATEGY TO ASSEMBLE THE NEEDED RESOURCES. A NUMBER OF ACQUISITIONS OF SMALL COMPANIES TURNED OUT EXTREMELY WELL -- SOME FAR BEYOND EXPECTATIONS. THE REASON WAS THAT THE SMALL COMPANY ENVIRONMENT -- FOR A TIME, AT LEAST -- WAS MAINTAINED IN CONTROL DATA. BUT THE DAY CAME WHEN GROWTH HAD CHANGED CONTROL DATA'S ENVIRONMENT TO THAT OF A BIG COMPANY. THAT WAS WHEN ACQUISITIONS BEGAN TO FALL SHORT OF OBJECTIVES AND SOME OF THE MOST CREATIVE PEOPLE WE HAD ACQUIRED BEGAN TO LEAVE.

IN SPITE OF ALL KINDS OF CREATIVE APPROACHES TO ORGANIZATIONS AND PROCEDURES, WE WERE SIMPLY UNABLE TO MAINTAIN AN ENVIRONMENT SATISFACTORY TO MANY OF THE MORE INNOVATIVE PEOPLE. RECENTLY A STUDY OF ALL ACQUISITIONS MADE BY CONTROL

DATA OVER A 22 YEAR PERIOD SHOWED THAT LESS THAN 15 PERCENT OF THOSE IDENTIFIED AT THE TIME OF ACQUISITION AS MEMBERS OF THE INNOVATIVE TEAM WERE STILL EMPLOYEES.

OUR EXPERIENCE IS CORROBORATED BY A HAYES ASSOCIATES STUDY OF 200 ACQUISITIONS MADE ON A VOLUNTARY CORE GROUP OF FORTUNE 500 COMPANIES WHICH SHOWED THAT ONLY 42 PERCENT OF TOP MANAGEMENT OF THE ACQUIRED COMPANY REMAINED AS LONG AS FIVE YEARS AFTER THE MERGER. THE FIGURE FOR ALL MERGERS WOULD BE SIGNIFICANTLY LOWER BECAUSE NORMALLY ONLY THOSE COMPANIES WITH THE BETTER PARTICIPATION RECORDS WOULD BE WILLING TO DISCLOSE THEIR EXPERIENCE.

EXPLODING MYTHS

IN ADDITION TO REVIEWING ADVERSE FACTORS, I SHOULD REPORT ON THE RECENT EXPLODING OF SOME MYTHS ABOUT SUPPOSED BENEFITS OF MERGERS.

ONE IS THAT THE THREAT OF A TAKEOVER PROVIDES A NECESSARY CHECK ON INEFFICIENT MANAGEMENT. THE IDEA IS THAT MANAGEMENT OF COMPANIES WHOSE PERFORMANCE IS SUBSTANDARD MUST EXPECT TAKEOVER TENDERS IF IT FAILS TO IMPROVE PERFORMANCE ADEQUATELY. THIS

OFTEN-CITED HYPOTHESIS HAS BEEN SHOT DOWN BY A STUDY OF MERGERS MADE BY DR. MERTON PECK, CHAIRMAN OF ECONOMICS AT YALE. HIS STUDY OF MERGERS OF MINING AND MANUFACTURING COMPANIES WITH ASSETS OF 60 MILLION DOLLARS OR MORE, SHOWED THAT ACQUIRED FIRMS WERE MORE PROFITABLE THAN THE AVERAGE OF THEIR INDUSTRY.

FURTHER CORROBORATION IS FURNISHED BY HARRY GRAY, CEO OF UNITED TECHNOLOGIES, THE LEADING COMPANY ENGAGING IN FORCED TAKEOVERS. HE HAS STATED THAT THE MAIN CRITERIA USED IN SELECTING TAKEOVER TARGETS INCLUDES PROFITABILITY, MARKET LEADERSHIP AND PROVEN MANAGEMENT. THUS, IT IS WELL-MANAGED COMPANIES RATHER THAN THE POORLY MANAGED THAT ARE THE MAIN TARGETS FOR TAKEOVERS.

AS A RESULT, THE THREAT OF TAKEOVERS OF THE MOST SUCCESSFUL FIRMS IS MORE LIKELY TO HAVE A NEGATIVE EFFECT BECAUSE MAJOR DECISIONS ARE OFTEN MADE WITH PRIMARY CONSIDERATION GIVEN TO "HOW WILL IT AFFECT VULNERABILITY TO TAKEOVER". FOR EXAMPLE, A NUMBER OF CEO'S OF MEDIUM SIZED COMPANIES HAVE TOLD ME THAT THEY HAVE FOREGONE UNDERTAKING HIGHLY DESIRABLE PRODUCT INNOVATIONS FOR FEAR THAT UNFORESEEN PROBLEMS WOULD CAUSE THE COMPANY'S MARKET PRICE TO FALL AND HENCE INCREASE TAKEOVER VULNERABILITY. OBVIOUSLY, STOCKHOLDERS, EMPLOYEES, COMMUNITIES AND OTHER CONSTITUENTS ARE ALL LOSERS IN THIS STIFLING MILIEU. INCREDIBLE! AND ANOTHER SOURCE OF ECONOMIC AND SOCIAL WASTE.

OTHER ALLEGED BENEFITS ARE THAT MERGERS ARE IMPORTANT IN INCREASING COMPETITION AND ECONOMIC EFFICIENCY. THESE MYTHS WERE EXPLODED BY CONCLUSIONS OF A PROJECT COORDINATED BY THE INTERNATIONAL INSTITUTE OF MANAGEMENT IN BERLIN. 765 MERGERS OVER A TEN YEAR PERIOD IN EUROPE AND THE UNITED STATES WERE ANALYZED. TWO OF THE CONCLUSIONS WERE THAT MERGERS DO NOT INCREASE PROFITABILITY OR INCREASE EFFICIENCY. THERE WAS ALSO THE CONCLUSION THAT THESE MERGERS HAD LITTLE SOCIAL VALUE.

A BETTER WAY

RESULTS OF THOSE STUDIES TRACK CLOSELY WITH MY OWN EXPERIENCES, STARTING WITH ERA AND THEN REMINGTON RAND, SPERRY RAND AND CONTROL DATA -- MOVING FROM A SMALL HIGHLY INNOVATIVE ORGANIZATION TO THE BUREAUCRACY OF A LARGE COMPANY, AND THEN BACK AGAIN TO THE SMALL INNOVATIVE ENVRIONMENT, WHICH AGAIN FINALLY GAVE WAY TO A BUREAUCRATIC GIANT. THOSE EXPERIENCES CONVINCED ME THAT THERE HAD TO BE A BETTER WAY THAN MERGER TO GET THE SOUGHT-FOR BENEFITS IN MANY CASES.

THE BETTER WAY IS COOPERATION THROUGH LICENSE AGREEMENT, JOINT PROJECTS OR JOINT VENTURES (JOINTLY OWNED COMPANIES). THROUGH THIS APPROACH, THE LEGITIMATE OBJECTIVES OF A MERGER CAN BE

GAINED WHILE PRESERVING THE INNOVATIVE, JOB-CREATING RESOURCES AND EITHER ELIMINATING OR LESSENING UNDESIRABLE EFFECTS. THIS IS NOT THEORY; CONTROL DATA HAS MANY SUCCESSFUL LICENSE AGREEMENTS, JOINT PROJECTS AND JOINT VENTURES. IN ORDER TO GAIN THE MOST BENEFIT FROM OUR EXPERIENCE, WE HAVE ESTABLISHED FORMAL POLICIES ON MERGERS THAT COVER NOT ONLY ACQUISITIONS BY CONTROL DATA, BUT THE CASE OF ANOTHER COMPANY WISHING TO TAKE OVER CONTROL DATA.

EMPLOYMENT CONTRACTS

ONE POLICY WE FOLLOW IS TO PROVIDE THREE YEAR, ANNUALLY EXTENDED EMPLOYMENT SECURITY CONTRACTS WITH EACH MEMBER OF TOP MANAGEMENT. THESE CONTRACTS ARE VIOLATED IF REPORTING LEVELS OR JOB RESPONSIBILITIES ARE CHANGED THROUGH A HOSTILE TAKEOVER. THOSE WHO ARE AFFECTED CAN RESIGN, COLLECT TWO PLUS YEARS OF SALARY AND SEEK EMPLOYMENT ELSEWHERE. ALL TOP CONTROL DATA EXECUTIVES EXCEPT ME HAVE SUCH CONTRACTS.

IT MIGHT APPEAR THAT AN AGGRESSOR COMPANY COULD BUY OFF THE EXECUTIVES WITH LUCRATIVE BONUSES TO STAY. HOWEVER, THERE IS A STRONG CONSENSUS IN CONTROL DATA THAT FORCED TAKEOVERS ARE AKIN TO THUGGERY AND THERE IS UTTER ABHORANCE OF BEING ASSOCIATED WITH A CROWD OF THUGS. SO RETENTION IS HIGHLY UNLIKELY EVEN IF SOMEONE WERE WILLING TO PAY THE VERY LARGE AMOUNT THAT WOULD BE REQUIRED.

SOCIAL JUSTICE POLICY

ANOTHER POLICY PERTAINING TO TAKEOVER OF CONTROL DATA IS CALLED OUR POLICY ON SOCIAL JUSTICE. WITH THE ESTABLISHMENT OF THIS POLICY, BETTER PROTECTION IS PROVIDED FOR EMPLOYEES, STOCKHOLDERS AND OTHER STAKEHOLDERS FROM THE INJUSTICES THAT RESULT FROM MERGERS, ESPECIALLY HOSTILE TAKEOVERS. CONTROL DATA STOCKHOLDERS TWO YEARS AGO WERE REQUESTED TO APPROVE THIS POLICY AS AN AMENDMENT TO OUR COMPANY CHARTER MAKING IT MANDATORY THAT THE DIRECTORS CONSIDER ALL SOCIAL FACTORS, NOT JUST PRICE, IN AN ATTEMPTED TAKEOVER. SIGNIFICANTLY MORE THAN 95 PERCENT OF THE INDIVIDUAL STOCKHOLDER VOTES WERE IN FAVOR.

ACQUISITION POLICY

ONE IMPORTANT ELEMENT IN OUR POLICY ON ACQUISITIONS BY CONTROL DATA IS THAT BUSINESS OPPORTUNITIES BE DEVELOPED PRIMARILY FROM WITHIN. EXCEPTIONS CAN BE MADE, BUT ONLY WHEN THE COMPANY THAT IS PROPOSED TO BE ACQUIRED WANTS TO BE ACQUIRED, AND FILLS A NEED OF CONTROL DATA THAT COULD NOT OTHERWISE BE ACCOMPLISHED INTERNALLY. FURTHERMORE, WHEN AN ACQUISITION IS MADE, IT IS OUR POLICY, WHENEVER FEASIBLE, TO ACHIEVE THE OBJECTIVES OF BOTH PARTIES IN A MANNER THAT LEAVES THE INNOVATING CAPABILITIES OF EACH COMPANY INTACT. THIS CAN OFTEN BE ACCOMPLISHED BY SPINNING OFF A SEPARATE COMPANY WITH ADEQUATE RESOURCES TO SUPPORT FURTHER INNOVATION, CONTROLLED AND MANAGED BY THE INNOVATIVE TEAM.

IMPACT ASSESSMENT: THE POLICY ALSO REQUIRES THAT IN THE EVENT OF A CONTEMPLATED ACQUISITION, A SOCIAL IMPACT ANALYSIS BE MADE AT THE EARLIEST STAGE IN THE DEVELOPMENT OF THE ACQUISITION PLAN. ADVERSE SOCIAL IMPACT THAT CANNOT REASONABLY BE CORRECTED IS CAUSE FOR REJECTION. BRIEFLY, OUR SOCIAL IMPACT ANALYSIS REQUIRES A STATEMENT OF THE REASONS FOR THE ACQUISITION, 5 AND 10 YEAR BUSINESS PLANS UNDER WHICH THE RESULTING BUSINESS COMBINATION WOULD BE OPERATED, AND AN ANALYSIS OF THE EFFECT ON ALL CONSTITUENTS, INCLUDING EMPLOYEES, THE COMMUNITIES IN WHICH PLANTS ARE LOCATED, SUPPLIERS AND CUSTOMERS. IN ADDITION, AN ASSESSMENT IS MADE OF THE EFFECTS ON THE INNOVATIVE CAPABILITIES OF THE ACQUIRED COMPANY.

INNOVATIVE LEGISLATION

WITH THAT BACKGROUND IN PLACE, I WOULD LIKE TO PROPOSE AN INNOVATIVE APPROACH TO MERGER LEGISLATION BASED ON THE BEST CRITERION FOR JUDGING THE MERITS OF ANY MERGER. THE CRITERION IS SIMPLY -- "DOES IT SERVE THE BEST INTERESTS OF SOCIETY?" OBVIOUSLY, THERE ARE MANY IMPORTANT CONSIDERATIONS -- INCLUDING COMPETITION, EFFECTS ON JOBS AND CAREERS OF EMPLOYEES, EFFECTS ON PRODUCTIVITY AND INNOVATION, EFFECTS ON STOCKHOLDERS AND COMMUNITIES.

THESE EFFECTS CAN BE ASSESSED BY REQUIRING A PRE-MERGER SOCIAL IMPACT ANALYSIS SIMILAR TO THE ONE USED BY CONTROL DATA. ACTUALLY, THIS WOULD ONLY BE AN EXTENSION OF PRE-MERGER NOTIFICATION PROCEDURES REQUIRED BY THE FEDERAL TRADE COMMISSION. THE MAIN DIFFERENCE IS THAT THE PRESENT SCOPE IS ONE-DIMENSIONAL, DEALING MAINLY WITH COMPETITION, WHEREAS WHAT IS PROPOSED EMBRACES OTHER EFFECTS THAT NEED TO BE CONSIDERED.

WHO IS TO JUDGE THE MERITS OF A PROPOSED MERGER? IT COULD BE A GOVERNMENT AGENCY OR THE STOCKHOLDERS OF THE MERGING FIRMS.

I FAVOR THE STOCKHOLDERS. MY EXPERIENCE CONVINCES ME THAT, GIVEN THE INFORMATION AND A STRUCTURED PROCEDURE, STOCKHOLDERS WOULD ACT IN A RESPONSIBLE MANNER.

AN IMPORTANT PROVISION WOULD BE THAT ANY INTERESTED GOVERNMENT AGENCY, ORGANIZATION, OR GROUP, INCLUDING EMPLOYEES, COULD FILE ADVOCACY MATERIAL SO THAT STOCKHOLDERS WOULD BE FULLY INFORMED.

WHENEVER I HAVE PROPOSED THIS PROCEDURE AT OCCASIONS LIKE TODAY, AND THERE HAVE BEEN MANY, THE CONSENSUS IS NOT SUPPORTIVE. LET ME READ THE SUMMARY PUBLISHED BY THE

CHAIRMAN OF THE LAST SEMINAR WHERE THE PROPOSAL WAS PRESENTED. QUOTE "JUDGING FROM THE TONE OF THE QUESTIONS AND STATEMENTS MADE BY PARTICIPANTS AT THE SESSION, THERE WAS LITTLE AGREEMENT WITH THE SPEAKER ON THE POINT THAT STOCKHOLDERS WOULD CONSIDER ALL ASPECTS OF A MERGER BUT WOULD ONLY LOOK AT THE BUCKS INSTEAD OF THE BROADER PICTURE". THIS REACTION IS TO BE EXPECTED FOR SEVERAL REASONS. ONE IS THAT MOST HAVEN'T HAD ANY REALLY RELEVANT EXPERIENCE IN DEALING WITH STOCKHOLDERS. AT THE TIME CONTROL DATA PROPOSED THE POLICY ON SOCIAL JUSTICE TO OUR STOCKHOLDERS, THERE WERE MANY INVESTMENT BANKERS, ANALYSTS AND OTHER EXPERTS WHO FORECAST THAT IT WOULD BE TURNED DOWN. BUT THEY WERE WRONG.

ANOTHER REASON IS THAT THEY HAVEN'T THOUGHT ABOUT THE ALTERNATIVE -- WHICH IS REVIEW BY A GOVERNMENT AGENCY. HERE AGAIN, MOST NEVER HAVE SOUGHT APPROVALS FROM GOVERNMENT AGENCIES CONCERNED WITH MERGERS AND THEREFORE HAVE NOT LEARNED FIRST HAND THAT THE AGENCIES HAVE TUNNEL VISION AND THE FLEXIBILITY OF A TWO BY FOUR PIECE OF LUMBER.

LASTLY, I BELIEVE THAT THE PROPOSED APPROACH INVOLVING STOCKHOLDERS WOULD MOST EFFECTIVELY ADDRESS THE ISSUE OF EXCESSIVE BIGNESS PER SE IS BAD. I DON'T KNOW ANYONE WHO WANTS TO WAKE UP SOME DAY AND SEE CONCENTRATION OF VIRTUALLY ALL BUSINESS IN A RELATIVELY

SMALL NUMBER OF GIANT CORPORATIONS. PUBLIC CONCERN OVER POWER OF LARGE CORPORATIONS IS REAL, AND THIS IS BEING EXPRESSED MORE FREQUENTLY AND STRIDENTLY. WITNESS THE RESULTS OF POLLS TAKEN IN THE U.S. ONLY EIGHT MONTHS AGO WHICH SHOWED THAT 70 PERCENT OF THE PUBLIC BELIEVED THAT LARGE OIL COMPANIES ARE HOLDING BACK SUPPLIES FOR HIGHER PRICES. THERE IS A WIDESPREAD CONCERN EVERYWHERE OVER THE ENVIRONMENTAL PROBLEMS OF NUCLEAR POWER. BIG IS BAD TO MANY PEOPLE IN SPITE OF LITTLE EXISTING SUPPORTING EVIDENCE OR THE ABILITY TO QUANTIFY THE SOCIAL AND POLITICAL EFFECTS OF COMPANY SIZE. AND THE ESSENCE OF THE THRUST OF SOME PENDING ANTI-MERGER LEGISLATION IN THE U.S. IS CONCERN OVER BIGNESS.

THERE IS MUCH WRITTEN AND SAID THESE DAYS ABOUT CORPORATE GOVERNANCE, WITH VERY LITTLE OF THE CONTENT BEING MEANINGFUL OR PRACTICAL. REQUIRING STOCKHOLDERS TO VOTE ON MERGERS WOULD BE A PRACTICAL AND PRODUCTIVE FORM OF RESPONSIBLE CORPORATE GOVERNANCE.

ALSO, OVER THE PAST DECADE, THERE HAS BEEN A GROWING ADVOCACY FOR GIVING EMPLOYEES MORE VOICE IN DECISIONS AFFECTING THEIR JOBS. THE APPROACH I AM PROPOSING WOULD PROVIDE IT IN A REASONABLE WAY WITHOUT IMPAIRING EITHER THE FLEXIBILITY OR RESPONSIBILITY OF MANAGEMENT.

THIS APPROACH WOULD EFFECTIVELY ELIMINATE FORCED TAKEOVERS AND WOULD ATTRACT CONSIDERABLE SUPPORT FROM THE CORPORATE COMMUNITY THAT WILL NOT SUPPORT THE LEGISLATION BEING PROPOSED IN WASHINGTON. MOST CORPORATE EXECUTIVES DO NOT BELIEVE IN FORCED TAKEOVERS, AND IN FACT WILL NOT ENGAGE IN THEM. YET, BEING HIRED HANDS AND FEARFUL OF INCURRING THE DISPLEASURE OF BOARD MEMBERS, AND/OR THE INVESTMENT COMMUNITY, THEY ARE RELUCTANT TO SPEAK OUT AGAINST FORCED TAKEOVERS. ALSO, I BELIEVE THAT MANY EXECUTIVES ARE CONCERNED THAT SPEAKING OUT MIGHT SUGGEST THEIR OWN VULNERABILITY TO TAKEOVER.

SUMMARY

IN CONCLUDING, LET ME REITERATE THAT THE WORST EFFECTS OF MERGERS ARE THAT POTENTIAL INNOVATIONS AND SOURCES OF NEW JOBS ARE ELIMINATED BY LARGE, MATURE FIRMS SYSTEMATICALLY BUYING UP HIGHLY INNOVATIVE MEDIUM-SIZED AND SMALLER FIRMS.

UNFORTUNATELY, MOST PERSONS IN OUR SOCIETY, INCLUDING MANY CORPORATE EXECUTIVES, DO NOT UNDERSTAND THE PROCESS OF INNOVATION, AND ITS TREMENDOUS IMPORTANCE TO OUR ECONOMIC WELL BEING. IN FACT, MOST PEOPLE DON'T EVEN KNOW WHERE MOST NEW JOBS COME FROM.

ONE OF THE GREATEST BENEFITS THAT WILL COME OUT OF PRESIDENT CARTER'S DOMESTIC POLICY REVIEW OF INDUSTRIAL INNOVATION IN THE U.S. WILL BE AN INCREASED UNDERSTANDING OF INNOVATION AND AWARENESS OF ITS IMPORTANCE.

IN ADDITION TO THE ECONOMIC DAMAGE DONE BY MERGERS, THERE IS THE SOCIAL INJURY THAT EMPLOYEES SUFFER FROM CAREER DISRUPTIONS AND LOSS OF JOBS, FAMILY TRAUMA, AND THE OVERALL HAVOC INFLICTED ON PEOPLE'S LIVES, TO BOTH EMPLOYEES AND OTHERS IN THEIR COMMUNITIES. THESE ARE INVARIABLY GREATER IN FORCED TAKEOVERS BECAUSE OF THE DIMINISHED OPPORTUNITY AND INCENTIVE TO DO RATIONAL PLANNING.

NOWHERE ELSE IN THE WORLD IS THERE A SOCIETY THAT ALLOWS PRIVATE ENTERPRISE NEARLY AS MUCH FREEDOM IN THE USE OF ITS RESOURCES AS DOES THE U.S. THEREFORE, CORPORATE RESOURCES MUST BE USED IN CREATIVE AND CONSTRUCTIVE WAYS THAT AVOID HARM TO SOCIETAL INTERESTS. TO DO OTHERWISE IS TO ASSURE EVENTUAL SIGNIFICANT REDUCTIONS IN FREEDOM OF ACTON. ANY UNDULY RESTRICTIVE REGULATION ON BUSINESS ACTIVITY TODAY CAN ALMOST UNFAILINGLY BE TRACED TO A REACTIONARY OR PASSIVE STANCE, RATHER THAN TO A CREATIVE INITIATIVE TO ADAPT TO CHANGING SOCIETAL CONERNS.

THE CONSTRAINTS ON BUSINESS THAT ARE ALREADY IN PLACE IN EUROPEAN COUNTRIES WILL SURELY BE ADOPTED IN THE UNITED STATES UNLESS CHANGE IS MADE VOLUNTARILY. FOR EXAMPLE, SIGNIFICANT CORPORATE MERGERS REQUIRE GOVERNMENT APPROVAL IN MOST OF THOSE COUNTRIES AND ALSO REQUIRE CONSULTATION WITH THE WORKER COUNCILS. PLANT CONSOLIDATIONS THAT RESULT IN REDUCED EMPLOYMENT ARE VERY DIFFICULT AND COSTLY TO ACHIEVE BECAUSE OF LAWS REQUIRING WORKER APPROVAL AND COMPENSATION OF FULL SALARY FOR UP TO TWO YEARS FOR LAYOFFS. IN SOME COUNTRIES, LAYOFFS REQUIRE PRIOR APPROVAL BY GOVERNMENT, AND IT IS TOUGH TO GET. FOR SEVERAL YEARS, FEDERAL LEGISLATION GOVERNING PLANT CLOSINGS HAS BEEN PROPOSED IN CONGRESS. MAINE AND WISCONSIN HAVE PASSED LAWS AND THE STATES OF NEW YORK AND MINNESOTA ARE CONSIDERING LEGISLATION. MOST RECENTLY ON THE NATIONAL SCENE IS THE COALITION CALLED AMERICANS CONCERNED ABOUT CORPORATE POWER COMPOSED OF LABOR, CONSUMER, ENVIRONMENTAL AND RELIGIOUS GROUPS, WHICH IS SPONSORING LEGISLATION ENTITLED "CORPORATE DEMOCRACY ACT OF 1980". ITS PROVISIONS INCLUDE THE REQUIREMENT FOR 24-MONTH NOTIFICATION OF PLANT RELOCATIONS AND SHUTDOWNS. TO HELP DRAMATIZE THE NEED FOR SUCH LEGISLATION, APRIL 17TH HAS BEEN DESIGNATED "BIG BUSINESS DAY" AT WHICH TIME THERE WILL BE TEACH-INS ON THE ROLE OF THE CORPORATION IN AMERICA IN WASHINGTON AND ABOUT 100 OTHER CITIES.

ADVERSE COMMUNITY REACTONS TO PLANT CLOSINGS COULD BE GREATLY ALLEVIATED BY PROVIDING A SOCIAL IMPACT ANALYSIS SIMILAR TO THE ONE PROPOSED FOR MERGERS. THAT WOULD INCLUDE THE EFFECT ON JOBS, SUPPLIERS AND OTHER AREAS ALONG WITH A DETAILED ANALYSIS OF THE REASONS FOR THE CLOSING. IN ADDITION, A PROGRAM SHOULD BE IDENTIFIED IN COOPERATION WITH THE COMMUNITY FOR EVENTUALLY REPLACING THE JOBS LOST; E.G., USING THE EMPTY PLANT TO HOUSE SMALL BUSINESSES THAT COULD BE STARTED UP.

ANY PLANT CLOSING RESULTS IN COST TO THE COMPANY AND ADDITIONAL DRAIN ON LOCAL GOVERNMENT UNITS FOR WELFARE AND UNEMPLOYMENT PAYMENTS. THERE ARE ALSO LOSSES TO THE LOCAL BUSINESS COMMUNITY BECAUSE OF DECREASED PURCHASES. SO THERE IS ECONOMIC INCENTIVE FOR THE COMPANY TO HELP FORMULATE AND IMPLEMENT A COOPERATIVE PROGRAM WITH THE COMMUNITY. SUCH AN EFFORT CAN BE MADE FOR NOMINAL COST. EVEN IF THE PROGRAM ONLY REPLACED A FRACTION OF THE JOBS LOST, THE WILLINGNESS OF THE COMPANY TO HELP, PLUS BEING OPEN ABOUT THE REASONS FOR THE PLANT CLOSING WILL GO A LONG LONG WAY IN AVOIDING BITTERNESS IN THE COMMUNITY AND OTHER ADVERSE REACIONS THAT ARE ALL TOO COMMON WITH PLANT CLOSINGS. BESIDES THERE ARE THE SAVINGS IN UNEMPLOYMENT COSTS TO BE REALIZED BY THE COMPANY.

RESTRICTIONS ON PLANT CLOSINGS ARE IN PART RESTRICTIONS ON MERGERS. ONCE LEGISLATION IS IN PLACE ON PLANT CLOSINGS, A LOGICAL EXTENSION IS RESTRICTIONS ON MERGERS. FURTHERMORE, IF PUBLIC CONCERN FOR THE SOCIAL TRAUMA OF TAKEOVERS DOESN'T BRING CONSTRAINTS, THE INCREASING ECONOMIC DAMAGE FROM UNEMPLOYMENT CERTAINLY WILL. AS UNEMPLOYMENT AND UNDEREMPLOYMENT RELENTLESSLY PERSIST, THE TIME WILL COME EVENTUALLY WHEN THE PUBLIC WILL UNDERSTAND HOW DIFFICULT AND CRITICALLY IMPORTANT IT IS TO PRESERVE EXISTING PRODUCTIVE JOBS AND TO CREATE NEW JOBS. BY THAT TIME, IT WILL BE CLEAR THAT ALL REASONABLE EFFORT MUST BE MADE TO AVOID THE LOSS OF JOB-CREATING RESOURCES. THEN, AS ALWAYS, SOCIETY WILL OVERREACT WITH TOO-STRINGENT CONTROLS.

THUS, THERE IS NOT ONLY A DIRE NEED BUT A GREAT OPPORTUNITY NOW FOR IMPLEMENTING THE INNOVATIVE APPROACH TO THE PROBLEMS OF MERGERS THAT HAS BEEN OUTLINED. THE OPPORTUNITY LIES IN THE GROWING CONSENSUS IN WESTERN SOCIETY THAT BUSINESS HAS RESPONSIBILITIES BEYOND JUST MAKING A PROFIT. THESE ARE COMMONLY CALLED SOCIAL RESPONSIBILITIES AND EMBRACE A WIDE RANGE OF ACTIVITIES. THEIR MAJOR THRUST IS THAT OF APPROPRIATE CONCERN FOR THE NON-SHAREHOLDER CONSTITUENCIES: EMPLOYEES, CUSTOMERS, SUPPLIERS AND COMMUNITIES. THIS MEANS

MANAGING THE PROCESS OF MAKING PROFITS FOR SHAREHOLDERS IN SUCH A WAY AS TO MAXIMIZE THE POSITIVE IMPACT AND MINIMIZE THE NEGATIVE IMPACT ON THESE CONSTITUENTS. POSITIVE ACTIONS TAKE MANY FORMS AND INCLUDE EQUAL JOB OPPORTUNITY FOR EMPLOYEES, IMPROVING CAREER OPPORTUNITIES FOR DISADVANTAGED EMPLOYEES, COUNSELING FOR CHEMICALLY ADDICTED EMPLOYEES, COMMUNITY IMPROVEMENT, PURCHASING FROM MINORITY BUSINESSES, POLLUTION REDUCTION, ENERGY CONSERVATION, IMPROVING PRODUCT QUALITY AND ASSURING SAFE WORKING CONDITIONS -- ALL IN ADDITION TO THE MORE TRADITIONAL CHARITABLE CONTRIBUTIONS.

KEY ELEMENTS IN THE INNOVATIVE APPROACH TO MERGERS ARE A SOCIAL IMPACT ASSESSMENT AND A DETERMINATION MADE BY THE STOCKHOLDERS OF BOTH COMPANIES ON THE MERITS OF ANY PROPOSED MERGER BASED ON THIS CRITERION: "DOES IT SERVE THE BEST INTERESTS OF SOCIETY?".

BY THE ROUTINE USE OF THE SOCIAL IMPACT ASSESSMENT, CONTROL DATA HAS PROVEN THAT IT IS A REWARDING BUSINESS PRACTICE IN ADDITION TO PROVIDING A MEANS OF AVOIDING OR MINIMIZING ADVERSE SOCIAL EFFECTS.

THERE ARE THOSE WHO CONTEND THAT BUSINESS IS ALREADY OVERBURDENED WITH TOO MUCH GOVERNMENT REGULATION AND ARE OPPOSED TO THE APPROACH I AM ADVOCATING. MY RESPONSE TO THEM IS SIMPLY THAT IF THE APPROACH WAS VOLUNTARILY AND WIDELY ADOPTED, LEGISLATION WOULDN'T BE NECESSARY. HOWEVER, I HASTEN TO ADD THAT WIDESPREAD VOLUNTARY ADOPTION WOULD, IF IT HAPPENED AT ALL, REQUIRE MANY YEARS. MEANWHILE, WITH DELAY, THE ODDS ARE HIGH THAT LEGISLATIVE RESTRICTIONS ON MERGERS WILL BE ENACTED. THEREFORE, CORPORATE EXECUTIVES HAD BETTER GET THEIR HEADS OUT OF THE SAND AND PUT ON THEIR FIGHTING CLOTHES. I'VE HAD MINE ON FOR FIVE YEARS. MOST CORPORATE EXECUTIVES, HOWEVER, SEEM AFRAID TO JOIN IN THE ACTION OR DON'T SEE THE DANGER OR ARE CONTENT TO RELY ON THE BUSINESS ROUND TABLE, THE U.S. CHAMBER OF COMMERCE AND OTHER BUSINESS ORGANIZATIONS WHO ARE DEFENDING THE STATUS QUO. SUCH THINGS AS THE UPCOMING TEACH-IN MIGHT CHANGE SOME VIEWS. MORE IMPORTANT FROM SOCIETY'S STANDPOINT, HOWEVER, IS TO AVOID FURTHER DELAY IN ELIMINATING SOCIAL WASTE CAUSED BY THE DESTRUCTIVE EFFECTS OF MERGERS. THIS WASTE, BEING LARGELY INVISIBLE AND NOT EASILY QUANTIFIABLE, DOES NOT ATTRACT THE ATTENTION IT DESERVES. A MAJOR HURDLE IN SUBDUING INFLATION IS THE ETERNAL AND LARGELY FRUITLESS QUEST FOR A FEW APPROPRIATE MACRO ECONOMIC ACTIONS, WHEN IN FACT, THE SOLUTION LIES IN A MYRIAD OF MICRO ACTIONS.

SUCH AS THOSE NEEDED TO STIMULATE THE EMPLOYMENT OF MILLIONS OF THE DISADVANTAGED AND DISABLED PERSONS IN OUR SOCIETIES, TO STIMULATE INDUSTRIAL INNOVATION AND TO ELIMINATE THE DESTRUCTION OF JOB CREATING RESOURCES AND SOCIAL TRAUMA CAUSED BY TAKEOVERS.

THE LATTER ACTION CAN BE ACCOMPLISHED THROUGH THE USE OF PRODUCTIVE BUSINESS POLICIES THAT DO NOT REDUCE THE PRESENT DEGREE OF OPERATING FREEDOM ENJOYED BY CORPORATE MANAGEMENT. DURING ALL MY YEARS AS AN EXECUTIVE, I HAVEN'T SEE A BETTER ANSWER FOR A BUSINESS PROBLEM WITH SO MANY RAMIFICATIONS.

APPENDIX EE.—STATEMENT SUBMITTED BY PROF. WILLIAM F. WHYTE, CORNELL UNIVERSITY

New York State School of Industrial and Labor Relations
A Statutory College of the State University

Cornell University, P.O. Box 1000, Ithaca, New York 14853

January 8, 1980

Mark J. Levine
Antitrust Subcommittee
Staff Assistant
B-363 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Levine:

As I told you over the phone, I will not be available to testify in the hearings you are proposing to hold on conglomerate mergers, but I think this is such an important project that I have dropped other things to put together the accompanying statement on "Confronting the Conglomerate Merger Menace." Let me add one minor point for your checking: in the last section of this statement, I have referred to a number of bills bearing on conglomerate divestitures and job saving, including that introduced by Representative William Ford. You will note that I do not have the number for that bill. If you print my testimony, let me ask you to fill in that number.

Let me make a suggestion regarding particularly representatives of big business that you might call upon to testify. It is only fair to allow official representatives of big business to make their statements in defense of conglomerate mergers, and so on, but I think it would be especially important to get testimony from chief executive officers of companies that have been involved in mergers where you have information suggesting that they have been involved in past actions that would cause them some public embarrassment, if they had to discuss these before your subcommittee. I gather you already have this in mind with the American Safety Razor Company case. I suggest that you check with Bennett Harrison at M.I.T. to get the facts on a statement that I understand was made publicly by the CEO of Genesco Corp. to the effect that it was the policy of his company to dump any plant that was not making 25% on invested capital. As I understand it, this statement was quoted in the Wall Street Journal, but I do not have the clipping, and Harrison was out of town when I tried to check this with him.

In the text of my statement, I suggested calling upon Joseph Alibandi, CEO of Whittaker Corporation regarding what happened to employment in the 92 companies that Whittaker absorbed before Alibandi took over and dumped under his leadership.

The general point I have in mind here is that traditionally big businessmen defend conglomerate mergers exclusively in terms of their assumed obligation to advance the interests of their stockholders. If you want these prominent executives to give some attention to the impact of their takeover projects on employment and community welfare, a Congressional hearing seems to me a very good place to start this kind of consciousness raising.

I will be leaving Ithaca on January 13 and leaving the country for Mexico and Central America January 22, to return on March 6. If you need to get in touch with me anytime after January 13, my secretary, Donna Updike (607-256-4530) will always know where to reach me.

Let me wish you every success in the important enterprise you are now beginning.

Sincerely yours,

WF Whyte

William F. Whyte
Professor Emeritus

dju

Enclosure

xc: Joseph Blasi

CONFRONTING THE CONGLOMERATE MERGER MENACE

Statement Submitted by

William Foote Whyte

Professor Emeritus

New York State School of Industrial and Labor Relations

Cornell University

To the Committee on Small Business

Subcommittee on Anti-Trust and Restraint of Trade

House of Representatives

96th Congress

2nd Session

This statement is based on research carried out in the New Systems of Work and Participation Program in Cornell University. In this research program, we have been focusing attention on labor-management cooperative problem solving in private industry and upon worker cooperatives and employee owned firms, especially those arising out of conglomerate divestitures.

We began with small scale case studies. As we sought to understand the problems and potentialities of saving jobs through transfer of ownership to employees or to employees and community people, we found the trail of evidence leading us to a reexamination of the nature of the U.S. economy.

This research has also led me to the conclusion that government policies and programs designed to combat economic concentration have failed to meet the challenge of conglomerate mergers. The battle has been fought on the wrong front. When a conglomerate takes over another company in a business in which the conglomerate has not been strongly represented, top management can often argue persuasively that the merger does not reduce competition.

If we are to devise effective measures to limit conglomerate mergers, Congress must open a second front in the long drawn out but only sporadically fought war against economic concentration. That second front should not be based upon the interests of consumers (the field in which antitrust laws may be adequate) but upon the interests of workers and citizens in communities threatened with conglomerate takeovers of local plants.

The case for change in government policy on conglomerate mergers must be based upon a realistic analysis of the nature of the U.S. economy. Let us begin the argument by seeking to separate popular myths from reality.

RECOGNIZING THE NATURE OF THE U.S. ECONOMY

For generations, public policy has been influenced by the ideology of free enterprise: the central notion being that individuals, free to seek their own economic interest in competition with others, would take actions that would contribute to the general welfare of society. Of course, even the most ardent free enterpriser recognizes the need for government intervention to maintain competition and to prevent decision makers from taking actions which would directly and blatantly damage the interests of others. Still they hold that governmental restraints are necessarily artificial and should be held to a minimum so as to allow natural economic forces to produce their expected benefits.

Although no one now visualizes the U.S. economy as responding to the independent actions of thousands or millions of individuals competing in the market place, there has been a tendency to personify the business firm and to assume that the firm decides and acts in terms of its own economic interests in a competitive market, just as the individual is assumed to do in the economic man model underlying the ideology of free enterprise.

To recognize the falsity of this vision, we need only to review the rapidly growing concentration of economic power.

According to Mark Nadel in his book, Corporations and Public Accountability, "Most of the country's manufacturing assets are in the hands of the 200 largest corporations that held 60 percent in 1972 - a jump from 47.7 percent in 1950." He goes on to report, "The third wave of mergers started in 1955 and peaked in 1969. In 1967, 1968, 1969 the merger movement reached all-time high peaks; an average of over 3,500 mergers occurred annually...by 1968, 89 percent of all mergers were conglomerate in nature." Nor were the companies taken over relatively small. "Between 1962 and 1968, 110 of Fortune's largest industrial corporations disappeared as independent companies."

Some spokesmen for business recognize that some unsound mergers took place in "the go-go years of the 1960s" but would have us believe that the merger fever has since subsided. While the number of mergers has indeed declined, the mergers of the late 1970s are bigger - and not necessarily better - than ever before. Newsweek reported (October 16, 1978) that, with almost a quarter remaining in the year, the deals recorded have

> already pushed the dollar volume of 1978 mergers well past the previous record of $24 billion set in 1969.

The problem with the economic man model of decision making is not that it is false but that it does not apply to the major decisions affecting the economy and the economic life of firms and communities. The economic man model applies very well under the following conditions:

1. The individual actor makes his own decision.

2. The individual actor expects to pay the costs and receive the benefits involved in carrying out his decision.

3. The individual actor is free to choose among two or more options. (If he has no choice, then he makes no decisions.)

When these conditions obtain, it is reasonable to assume that the individual is making decisions in accord with his economic interests. If the economy were made up solely of such individuals, competing with each other, then it might be reasonable to assume that the outcomes of all these decisions would advance the general welfare.

Let us now proceed to separate myth from reality.

In examining the conglomerate merger game, we must not fall into the trap of personifying the corporation and treating it as if it were an individual. The key merger decisions are made by individuals - a single actor or a small group of actors, inside the corporation or outside of it. (The outside actors we will consider later.) The key actor may pay few if any of the costs of such a decision, while he gains substantial benefits financially, in addition to the enhanced prestige accruing to the big business man who becomes a bigger business man. The other costs and benefits flowing from this decision fall upon the hundreds or thousands of other individuals, inside his firm or outside of it, who have no opportunity to decide whether the decision is in their best interests.

In hostile takeovers, even the top decision makers of the acquired firm have no opportunity to decide what is in the best interests of themselves or of their firm. In a friendly takeover, top executives of the acquired firm may receive a price substantially above the market for their stock, plus other future financial inducements, whereas the rank and file employees and minor officials receive no inducements and make no choices.

For example, in discussing the Xerox Corporation's takeover of C.I.T. financial corporation in 1968, Forbes Magazine (October 15, 1968, page 30) made this observation:

> Among the biggest gainers will be CIT's top management... if the merger goes through, they could end up with a combined stock market gain (on their own personal stock options) of approximately $10 million, a gain which CIT on its own probably couldn't have achieved for many, many years. (I am indebted to Barry Bluestone and Bennett Harrison for drawing my attention to this item.)

It is not even necessary for the conglomerate raider to be successful in his takeover effort in order to make a handsome profit. The skillful conglomerator can lose his bid and yet make millions of dollars by getting the takeover targets to pay what amounts to ransom in buying back their freedom. Consider the case of Joseph Gaziano, who told Aimee L. Morner, "My dream is simple - to build an empire." (Fortune, March 12, 1979) As chief executive officer of Tyco Laboratories, a small New Hampshire conglomerate, he has been making money for himself and his company primarily by buying and selling the stock of other companies. The strategy seems simple indeed. Using the resources of Tyco, Gaziano begins buying stock in a company he would like to bring in to his mini-empire. In one series of deals beginning in 1976 he began buying stock of Leeds and Northrup. Faced with this threat, the executives of the target company decided they would prefer a friendly merger and arranged to sell a block of stock to Cutler-Hammer, a Milwaukee electronic and electrical equipment company more than three times Tyco's size. Gaziano countered by buying heavily into Cutler stock. This led Leeds and Cutler together to seek merger partners more attractive to them than Tyco. At this point, Gaziano did not have the funds to continue in the game, but he sold his stock in the two companies at an after capital-gains tax profit of $12.9 million. As he commented, "Coming in second best isn't so bad if you make a few million dollars each time."

Gaziano was similarly unsuccessful in his effort to take over Trane, the Wisconsin manufacturer of air-conditioning equipment. Again he profited from the effort, getting Trane to buy back its freedom, through intermediaries, at 21% over the market price, yielding Tyco a net profit of $1 million.

With the profits from his previous deals, Gaziano decided to go after Cutler and Hammer again, investing $93.6 million to buy 32% of the outstanding stock. To take over the company, Gaziano would have needed to raise $200 million more. Before he had figured out how to do this, Cutler-Hammer people arranged for a friendly takeover by the still larger

Eaton Corporation. Through an investment banking intermediary, Eaton approached Gariano, who agreed to sell his 32% of Cutler-Hammer at a profit of $5.5 million.

The bonus received by Gariano is based upon return on stockholders equity. While the company's record of operating profits is mediocre and has been declining, the conglomerate merger game enabled Tyco to reach a spectacular 31.8% return on stockholders' equity for the fiscal year ending May, 1978. For this performance, Tyco paid Gariano $442,514, about half of it as a bonus – not bad for a mini-conglomerate.

Before passing on to other cases, we should note the falling dominoes effect of the takeover attempts of such a raider as Gariano. The Leeds executives would have preferred to remain independent but agreed to a merger with Cutler-Hammer in order to save themselves from Tyco. Similarly, executives of Cutler-Hammer apparently had no desire to lose their independence but preferred to merge with Eaton Corporation rather than being captured by Tyco. Thus, while he failed in his efforts to take over either Leeds or Cutler-Hammer, Gariano's maneuvers precipitated two defensive mergers.

Consider also the important roles that may be played by actors outside of either firm involved in the merger.

In an important study of Bank Control of Large Corporations in the United States, David M. Kotz found that in 1969 69 of the 200 largest non-financial corporations (34.5%) were controlled by banks or other financial institutions. Control was stated to exist when either of the following conditions was met:

> 1) a financial institution held 5% or more of the company's voting stock, with full or partial voting authority over the stock;
> 2) a financial institution was the leading supplier of debt capital to a company that relied on debt

> capital to a substantial extent and the financial institution was strongly represented on the company's board of directors.

In such a situation, it is unrealistic to visualize the banker making a detached judgment of the economic merits of a loan, either in terms of his own interests or those of his bank. In over a third of our largest companies, the banker sits on both sides of the table.

We should also recognize that, even when a banker seeks to act in terms of economic rationality, he is naturally inclined to make a given loan decision in relation to other potential transactions of the bank. For example, Kotz reports that Chase Manhattan owned sufficient stock to control Gulf and Western, which became the outstanding growth-through-takeover company of the late 1960s. In January of 1964, Gulf and Western opened a line of credit with Chase Manhattan. Chase provided G & W with a flow of information about companies in which G & W had an interest, "including suggestions for acquisitions." Backed by the Chase line of credit, G & W engineered takeovers that by the end of 1969 had advanced it to number 33 on the Fortune 500.

> In return, Gulf and Western had new subsidiaries transfer their checking accounts to Chase, deposit payroll and withholding taxes with Chase, and transfer pension plans to Chase Manhatten's trust department.

This implicit exchange of takeover loans for future banking transactions seems to be a common phenomenon. Reporting on two studies of takeovers of Wisconsin firms by outside corporations, William A. Strang (Out of State Acquisitions of Wisconsin Businesses, Hearing before the Select Committee on Small Business, United States Senate), March 12, 1979) reports that in 48% to 70% of the cases most of the banking transactions were shifted to the bank serving the firm engineering the takeover. Furthermore, the shift in most cases was from smaller to larger banks, thus increasing economic concentration in banking as well as in industry. The large New York and Chicago banks have been the major beneficiaries of this trend.

Nor is the case of outside actors exhausted when we finish with the bankers who lend money for the acquistion. Investment banking firms are increasingly active as arrangers of shot-gun corporate marriages. Newsweek (Oct. 16, 1978) reports that

> First Boston, for instance, has a "creative director" whose sole job is to scour the corporate terrain for attractive acquisition candidates. Morgan Stanley has a computer system, called the "plum picker", to do the same thing.

It is a lucrative business. Again, according to Newsweek

> Stephen Friedman, head mergers-and-acquisitions man at Goldman, Sachs and Co., says his business has increased fourfold since 1975...as a rule of thumb, an investment banker gets a flat fee of $1 million on a $100 million deal and $2.5 million on a $500 million transaction.

MYTH AND REALITY OF COMPANY GROWTH

According to the traditional wisdom, a company grows through providing better values in goods and services in the market place. The company achieves such a success through research and development projects that yield it well designed and useful products to produce, through efficient management of the production process, and through skillful marketing.

The company that achieves success along these lines creates more wealth for everybody: more jobs as it expands its market, better paying jobs through attracting superior human resources, more money in dividends for stockholders, and easier access to capital to finance its expansion.

If that indeed were the predominant pattern of organizational expansion, then there would be little need for congressional and public concern regarding the growth of business. In fact we are finding increasingly that growth is achieved by buying rather than building companies.

If we look at the backgrounds of the leading players of this game, we do not find experts in research and development, manufacturing, or marketing - areas of activity that increase the wealth of our nation. The leading players are those skilled in financial manipulation and legal maneuvering. Furthermore, it is not only the chief executive officers of the takeover company and the potential target that are involved in the conglomerate game. Prominently represented among the players are bankers, arbitrageurs, accountants, and lawyers.

As we have seen, this is a game that the chief executive officer may be forced to play against his will. That is, if he does not take over some other company or get some friendly company to take him over, he may be taken over by Joe Gaziano. The conglomerate game has become a prominent part of our economic system, and the system itself shapes the behavior of its players.

The increasing prevalence of the conglomerate merger game must have serious negative effects upon productivity and price stability. The behavior of top executive officers has far greater impact upon the production of goods and services than the behavior of masses of workers. Psychologists discovered long ago that human beings tend to repeat the behaviors that have brought them rewards in the past. If the CEO has discovered that he can make much more money for himself and for his company through trying to take over other companies than through devoting his energy and ingenuity to improving research and development, manufacturing, and marketing, then he will continue to go where the money is. While he blames labor for lagging productivity in the operations of his company, he devotes his attention to the big money game, completely divorced from the hard realities of production and distribution.

We should note further that the rewards available to the raider force the key executives of the target company to concentrate their attention on the financial and legal maneuvering necessary to escape his clutches. In other words, the conglomerate merger game has the effect of drawing the attention of the key decision makers in the target companies away from those activities that would enable their companies to do a more efficient job in the production of goods and services.

THE MYTHS OF BIG BUSINESS

Our studies have indicated the falsity of three commonly held beliefs about big business. Let us examine these myths.

1. Expansion of big corporations creates jobs and is therefore an important factor in reducing the national level of unemployment. At the beginning of 1969, the 1000 largest corporations provided over 20% of national employment. In the following eight years through 1976, total national employment rose by more than 9.5 million. What percentage of that increase was contributed by these 1000 largest corporations?

I have asked three classes of Cornell students to guess the correct answer to that question. Their guesses have ranged from 3% to 70%, with most answers falling between 20% and 35%. The correct answer? Eight-tenths of one percent! (Congressional Record, March 8, 1978, report by Congressman John Breckinridge on a study carried out for the House Sub-Committee on Small Business, Anti-Trust, Consumers and Employment.)

To be sure, it may be argued that most of the 1000 largest corporations are engaged in manufacturing, a field which has been providing a decreasing percentage of national employment in recent decades. However, that observation simply helps to explain the figures; it does not change their basic meaning: whatever else they may do for the U.S. economy, we cannot expect the largest corporations to be a major factor in hiring enough people to produce a substantial decline in unemployment.

We have to look to the other end of the size scale to find where the jobs are coming from. According to research by David Birch (The Job Generation Process. Report to Economic Development Administration, 1979), over the years 1969-1976 66% of the net growth of jobs occurred in firms employing 20 or fewer people. Furthermore, he reports similar findings for Canada, England, and Japan.

Do mergers tend to lead to reduction of jobs through plant shutdowns? Since the first five cases we have studied all involved plants taken over by conglomerates in the 1950s and 1960s and in the process of being shut down when employees or an employee-community group saved the jobs through buying theplants, we suspected these might represent a general trend. In the 1970s it seems to have become common practice for top management of conglomerates to reexamine the plants it picked up in earlier mergers and to dump those falling short of its standards of financial performance. Writing in the New York Times (January 31, 1978) Deborah Rankin gives this report in a column on "Taxes and Accounting: The Issue of Big Bath Write-offs."

> The final months of the year are often accompanied by a flurry of corporate bombshells announcing the write-off of unprofitable plants or product lines. The latest rash of disclosures - headed by the announcement of G.D. Searle and Company that it plans to dispose of some twenty money-losing businesses - raises anew the issue of "big bath" accounting.

She goes on to quote "an analyst who requested anonymity" as follows

> "When new management comes in, the big bath approach allows the CEO (chief executive officer) to wipe the slate clean so he can say, 'First quarter earnings have gone up markedly since I took over.' Well, of course, earnings have gone up since the guy threw out all the garbage as soon as he arrived on the scene."

What the analyst does not say is that thousands of jobs went out with the "garbage". As we are discovering, some of these plants were viable economic units before they were taken over by the conglomerate and were only turned into garbage by conglomerate mismanagement. Furthermore, some of the shutdown plants cannot accurately be called "money-losing businesses" since they had been making a profit even under conglomerate management but had not been making the high profits the conglomerate decision makers expect from other lines of their business. Finally, this does not take into account those plants which could have made a profit if they had been burdened by a heavy corporate overhead payment.

It is easy to find large and spectacular cases supporting this thesis. For example, consider the Okonite Company in New Jersey, a manufacturer of cables, which had been a steady profit maker for the 75 years of its independent existence. But then, as a high official of Okonite explained to me, "During the last ten years, we were owned twice by Jimmy Ling. That says it all!" Even under this conglomerate management, Okonite continued to make profits. Nevertheless, when the Ling financial empire collapsed, the 1800 workers in Okonite would have lost their jobs if the leaders of the subsidiary had not been able to extricate Okonite from the wreckage and reestablish it as an independent (employee owned) company, with substantial loans from EDA and banks.

In 1969, with the aid of $175 million in bank loans, Lykes Corporation took over a company with capital assets five times as large as its own figures. In the following years, Lykes reinvested in Youngstown Sheet and Tube Company only a little more than half of what it claimed in depreciation on that subsidiary, using the money saved during good years for steel to buy other companies. When the downturn came, Lykes found itself with an obsolescent steel company on its hands, and the Lykes chief executive officer estimated that it would take bank loans of over $550 million in a ten year period to make the steel company once more economically viable. Since bankers were not inclined to put up that money, Likes closed the mills, putting 5000 people out of work in the Youngstown area.

Even when a rapidly expanding conglomerate survives an economic disaster and makes a comeback, we must ask what effects its roller coaster performance has had on employment. Consider the case of the Whittaker Corporation, as reported by Dan Dorfman (Washington Post, December 16, 1979, p. F14).

> It started out as an aerospace company in 1947 but then went on to acquire more than a hundred different firms between 1967 and 1970. Reflecting its meteroric growth, Whittaker shares went through the roof rising from 6-3/8 in 1967 to 45-7/8 just a year later. But then the roof caved in (as did its stock) when the company virtually lost control over the management of its various businesses in 1970. It was also the year in which the debt-ridden and highly leveraged company was stung with $8.5 million loss on some $800 million in sales. Whittaker seemed headed for the scrap heap. But then came a major restructuring of the company under a new chief executive (Joe Alibrandi, formerly a senior vice president of Raytheon), the subsequent divestiture of 92 businesses and deeper involvement in the fast-growing hospital management or life sciences field.

According to Dorfman, this is a story with a happy ending. He adds that

> The stock of the $1 billion company recently surged past 18 in accelerated trading activity...as things stand now, the company's earnings are booming.

Let us now ask questions that are relevant only if one looks beyond stockholder interests. What was the level of employment in these 92 abandoned companies when taken over by Whittaker? What was their level of employment when they were dumped by Whittaker? (Since the conglomerate had got itself into deep trouble before Alibrandi began the divestiture process, we assume that comparison of those two figures would show a substantial loss of jobs during the period of Whittaker ownership of these 92 companies.) How many of these 92 companies went out of business when they were dropped by Whittaker? How many jobs were lost in this going out of business process?

I do not have the answer to these questions. I suggest that your committee call upon Mr. Alibrandi and his staff to do the research necessary to provide those answers.

I am not suggesting this measure in order to penalize Mr. Alibrandi. Obviously, he cannot be held responsible for the conglomerate merger binge that preceded his employment with Whittaker, and he may well argue that his divestiture program was necessary to restore Whittaker to a position of strength that enables it to continue providing jobs as well as useful goods and services. I suggest this job loss accounting because I think it is important for business leaders as well as for congressmen to give serious attention to the employment effects of the conglomerate merger and divestiture process.

I am not suggesting that a conglomerate merger always leads to a reduction of employment. In fact, preliminary examination of figures supplied by United Technologies, the most spectacular case of conglomerate growth in the 1970s, shows an employment gain from the end of 1973 to September, 1979 of about 6,000, above and beyond the number of jobs in the acquired companies at the time of the takeovers. I have been arguing that there are enough negative cases, showing large drops in employment, already in the record so as to suggest that the effect of the conglomerate merger - divestiture process on the economy as a whole in recent years has been to reduce employment.

2. A big company would not shut down a plant that was making money. Of course, many of the plants shut down have been losing money, yet we have found cases of consistent profit makers that have nevertheless been closed. How can that be?

A plant producing library furniture in Herkimer, N.Y., had made a profit 19 out of the 20 years it had been owned by Sperry-Rand, yet it had not been yielding the approximately 20% that the conglomerate decision makers expect on their invested capital, and, furthermore, it did not fit into the business strategy of the chief executive officer. Sperry-Rand officials estimated that they could get more for their money by shutting down the plant, declaring a tax loss, and selling the machinery than they could by continuing to own and operate that plant.

For generations the name of Bates had been a symbol of top quality in fabrics, yet in 1977 management decided to shut down its sole remaining textile mill in Lewiston, Maine. In the 1960s the Bates Company had begun to acquire companies in the fields of energy and natural resources. Finding that these firms yielded around 15% on invested capital whereas Bates could only expect 5 to 7% in textiles, the conglomerate leaders made the rational decision to close the Lewiston plant and shift their capital to more lucrative fields.

What was rational to the conglomerate made no sense to the 1100 workers in the Lewiston plant nor to local business and community leaders, faced with the loss of the largest payroll and the largest source of taxes in their city. With the aid of a loan guarantee from the Farmers' Home Administration, the employees and local management people secured bank credit (at 10 1/4%) to buy the plant and save the jobs. Management spokesmen now estimate that they will be able to make substantial investments to modernize the plant, meet the loan payments, and make a profit of 5 to 7%.

Incidentally, this case provides an answer to a question often asked us: if the plant could be expected to make a profit, why did not some private investors come along and buy it? If he had no interest in jobs and business in Lewiston, what private investor would consider making an investment involving a substantial risk and promising to yield 5 to 7% return on his money? On the other hand, from the standpoint of the workers and their fellow citizens of Lewiston, a return of 5 to 7% on an investment that would save 1100 jobs and maintain a major source of local taxes and local business was a very attractive proposition indeed.

Finally, consider again the case of the Okonite Company, which had been a steady profit maker. When the conglomerate which had taken it over 10 years earlier went bankrupt, top management would have had no choice but to shut Okonite down - if workers, local management, and company officials had not worked together to extricate Okonite through transformation of ownership.

3. Big business is efficient. Therefore, you cannot expect local workers and managers to make a go of an operation whose performance did not satisfy the decision makers of the big company. It would be all too easy to deflate the image of big business efficiency by citing examples of gross mismanagement, but that would put the issue in the wrong context. We are not trying to prove that big business executives are, in general terms, less efficient than small business leaders or leaders of employee

owned firms. We are seeking to discover the situations in which small business firms and especially employee owned firms may make an economically viable operation out of a plant being abandoned by a big corporation.

ORGANIZATIONAL EFFICIENCY FOR JOB PRESERVATION

Since the record is now clear on this point, we no longer need to answer the question: Can conversion to employee or employee-community ownership save jobs? Still, when we tell our story, many people find it very mysterious that such a firm can succeed where big business has abandoned the plant. While the explanations for success will vary from case to case, we are already finding important common elements.

1. Escape from remote control decisions. In the case of the precipitous drop in volume of business and profits following one conglomerate takeover, we have documented a series of bad decisions. One example should serve as an illustration. Cluett-Peabody decided to save money in marketing by dropping the Van Raalte salesmen and having the Cluett-Peabody salesmen add the Van Raalte line to their wares. While this saved selling expense, it had a drastic impact on Van Raalte sales. The station wagons the salesmen used were not large enough to contain samples of all of the Cluett-Peabody lines plus the Van Raalte products, so some of the Van Raalte items got left behind. Furthermore, the Cluett-Peabody salesmen did not know the Van Raalte merchandise as they did the lines in which they had had long experience, and so the whole selling campaign broke down.

When the Saratoga Knitting Mill became an independent unit, President Donald Cox contracted with a small and aggressive New York marketing firm that mounted a successful campaign to sell the fabrics produced at Saratoga Springs in the markets for which they were especially designed.

2. Restraints imposed by top management. Consider the case of what was the Library Bureau plant belonging to Sperry Rand. The plant had always had its own sales force and was not dependent upon Sperry Rand for its market. In fact, being part of the conglomerate imposed serious barriers in marketing. For example, it was a rule of Sperry Rand that the Library Bureau salesmen could not call on any customers served by Sperry Rand. While this left to Library Bureau its main markets with public and educational institution libraries, the rule barred the plant from selling to a large number of industrial and business firms that used library equipment. The Library Bureau could only enter these markets through Sperry Rand salesmen, who were unfamiliar with Library Bureau products and had moreimportant things to sell. The handicaps were similar in the export field. The Library Bureau could enter the export market only through the international division of Sperry Rand. Robert May, formerly head of sales for the Library Bureau and later president of Mohawk Valley Community Corporation, explains what would happen in these words:

> We were not officially barred from exporting, but to sell anything outside of the country, we had to send our proposal to the international division, and it would just die there. We would never hear anything back.

Since the establishment of employee-community ownership, the Mohawk Valley Community Corporation has mounted an aggressive export campaign, which is bringing in millions of dollars in foreign orders.

In other cases, top management vetoes the plans of a local plant to produce a particular product because top corporate strategy has allocated such items to other units. Consider the case of Al-Tech, a company formed by 33 managerial employees staving off shutdowns by purchasing two Allegheny Ludlum plants. (Rank and file employees are now included in ownership through an ESOP.) The chief executive of the new firm reports that Al-Tech has added production of new items, especially appropriate for its own facilities and talents, but which it could not produce earlier because of the corporate veto. This expansion into new lines of production partially accounts for a 10% expansion of employment in the two plants since they became an independent company in 1975.

Note also the broader societal implications of this point. This is not simply a question of the interests of the local units against those of the total corporation. As the corporation controls a growing number of local units, it can and often does eliminate competition among these units, so that the liberation of some of these plants from the control of the conglomerate can help to revive competition in an increasingly conglomerate controlled economy.

3. "Modernizing" the job shop. Conglomerate executives and staff specialists are likely to be graduates of business schools, where they have learned from books designed for mass production operations and therefore apparently requiring elaborate systems of organization and control. When they visit the job shop, engaged in producing a wide variety of items, one-by-one or in small batches, they are likely to be appalled by the apparent confusion and disorganization. Furthermore, they are likely to have had their chief experience in operations yielding a much higher margin of profit than is produced by the job shop. Such individuals have a natural tendency to assume that the profit differential observed is due to the superior management skills of their own higher management people rather than being due to the inherent nature of different types of industrial operations or to the nature of the market. They therefore assume that if they "modernize" the job shop, imposing the systems of organization and control that they have used in other operations, they can turn the plant into a really efficient unit.

The results of acting on this mystique of the management generalist are often disastrous. In Jamestown, four plants that had been bought up by conglomerates in the 1960s and had then been "modernized" into financial disaster were only saved from closing when then Mayor Stanley Lundine and the Jamestown Area Labor-Management Committee were able to raise the money and work through the many other problems to transform them to local ownership: employee owned in one case, owned by the top management people of the newly for[illegible] local firms in the other three cases. Now that the decisions in these plants are being made by people who know what they are doing, all four companies are economically successful and maintaining or increasing employment.

When the now employee owned firm, Jamestown Metal Products, was owned by a conglomerate, top management sought to plan and control production scheduling and work flow within the plant through the use of a computer. That operation required two employees within the plant and one in the home office, plus substantial costs in computer time. Local management complained that the computer gave them nothing but garbage, but top management rejected their "old fashioned ideas". Now that the plant is employee owned, the records necessary for production scheduling and work flow are maintained by a single employee who works half time on other assignments. And the now unmodernized company is doing very well, paying out substantial amounts in profit sharing to workers and currently having a book value about three and a half times the figure at the time of the transfer of ownership in 1973.

We recognize that the computer can be useful and even invaluable in some types of business operations, but its efficiency depends upon the potential for routinization of the activities it monitors or controls.

Consider this hypothetical case that may be representative of many job shops. The plant has seven different types of machines, with varying numbers of each type. Even within machines of the same type, there is variation in age and in speed of operation and quality of performance. The plant produces a large number of different items in single units or in small batches. Some items are worked on by several types of machines, and some items require the unit to go from Machine type A through B and C and then back to A - and so on. Performance depends upon the skill and diligence of workers and upon scheduling so as to keep machines and workers busy, reducing machine down time or worker waiting time, and so on.

In this situation, the number of different paths a given unit might follow from machine to machine is well nigh infinite. This is not to say that it would be impossible to develop a good computer program to schedule production and work flow. However, the complexity of the task is so enormous as to require intensive and extended studies in industrial engineering. Even then, whenever there was a change in the market, the old programs would become obsolete, and new studies would be required. Therefore, while it is possible to develop good computer programs for such operations, the costs far outweigh the benefits.

Without computers, how do job shop people make decisions on these scheduling and work flow problems? Their decisions are partly intuitive and partly carefully reasoned but, in any case, based upon past experience and intimate familiarity with the characteristics of workers and machines.

This is not to say that management skill and experience are unimportant for an employee owned company. It seems significant that, in all five cases we have studied, one or more key members of local management remained with the plant as it became employee or employee-community owned. I am simply arguing against the mystique of the management generalist:

the idea that a good executive in one situation will automatically be a good executive in a quite different situation. The effective executive in the employee owned firm will be someone who, besides what he has learned in formal management courses, has a wealth of experience in the particular line of production and marketing in which the firm is engaged.

4. Shedding corporate overhead. When the Library Bureau was part of Sperry Rand, the Herkimer plant was contributing $600,000 a year in corporate overhead. When I asked John Ladd, a member of the board of the Mohawk Valley Corporation, and, as Director of the Mohawk Valley Economic Development District, the key figure in converting ownership of the plant, how much value he thought the Herkimer plant had been getting in return for that $600,000 he replied, "I would say it was worth about $1.50."

While that figure may have been somewhat of an underestimate, it does point to a general problem. When a branch plant is one among a number of plants producing similar items and with similar problems, corporate management can provide many services of value to all of those branch plants. When the plant in question is one of a kind or fits into a very small part of a conglomerate whose major interests are in other lines, then the services provided by corporate headquarters are unlikely to be worth the cost. Thus, the new company improves its profit position substantially by getting out from under the corporate overhead burden. In fact, in the Herkimer case, in the first year of employee-community ownership, the Mohawk Valley Community Corporation put $200,000 into its employee stock ownership trust and paid dividends amounting to 17% on invested capital, and yet the combined total of these two amounts came to somewhat less than the $600,000 of corporate overhead saved. In other words, in this one case, the dropping of corporate overhead made the difference between a break even operation and a substantially profitable firm.

5. Improvements in employee motivation and productivity. In a study commissioned by the Economic Development Administration, Michael Conte and Arnold Tannenbaum have found in general that employee owned firms tend to show superior records both in job satisfaction and in financial performance. In 30 firms where the researchers were able to get profit figures, Conte and Tannenbaum report

> that employee owned firms can function efficiently and profitably. Furthermore, analyses concerning the possible determinants of profitability of these 30 companies indicate that the single most important correlate of profitability among the aspects of ownership that we measured is the percent of the company's equity owned by non-managerial employees. The greater this percent, the greater the profitability of the firm.

6. Reducing the costs of controlling worker behavior. While employee motivation seems an intangible item, as we get down to cases, we can link it with concrete economic results. Consider these examples from Saratoga Knitting Mill. When under outside ownership, the plant employed three janitors. Now with employees taking care to keep their own work areas clean and neat, there is only a part-time janitor, and the factory floor is as clean as it has ever been. Prior to the ownership change, the pilferage problem was serious enough to require a guard service. This service was terminated following the purchase, and yet the incidence of pilferage has been reduced almost to zero.

Another important gain was made in the reduction of fabric loss. Apart from pilferage, fabric is lost through the trimming of edges, damage, and so on. Under conglomerate ownership, a 1% allocation of the total manufacturing cost was budgeted for fabric loss. During the first year of operation of SKM, only .25% of net sales was incurred as a loss of fabric. Similarly, in the textile industry an average of 20% of batches have to be redyed because the color is not the correct shade or there are inconsistencies in the color. Consequently the conglomerate management allowed for this with a budget allocation of 3% of manufacturing costs. With increased quality concern among the employees, the redye costs for the first year of SKM were only .5% of net sales. In the words of one foreman, "Now that they own the plant, they take care of getting the colors closer."

There is also a large potential for savings in the costs of supervision. In the traditional private firm, the foreman is expected not only to be a coordinator and work scheduler but also a policeman, seeing to it that workers obey the rules, meet company standards on output and quality, keep working diligently, and so on. To the extent that the policing functions can be dispensed with, the firm needs fewer supervisors. This is shown strikingly as we compare supervision in the plywood worker cooperatives and in comparable private firms. Edward Greenberg reports one case in which a private company bought out a cooperative and immediately hired seven additional foremen. He estimates that in general private plywood firms have four times as many supervisors as worker cooperatives of the same size. Nor is the reduction in supervisory costs achieved at the expense of worker productivity. As Paul Bernstein and others have reported, the plywood cooperatives in recent years have far exceeded the productivity performance of private plywood plants.

While noting the very large potential of the transformation of ownership for increasing worker productivity and improving overall firm performance, we should recognize that these results do not come about automatically with a shift from private to employee ownership. In fact, the most impressive record has been made by the plywood cooperatives where workers are involved in decision making to an extraordinarily high degree.

In the conglomerate divestiture cases we have studied, the leaders of the new employee owned firm tend to try to carry on business as usual as if the shift in ownership required no change in the decision making process. In such cases, the firm will fall far short of the theoretically possible gains in productivity and organizational efficiency.

WHAT SHOULD CONGRESS DO?

I applaud the Subcommittee for devoting serious attention to this extremely important problem of conglomerate mergers. The actions I suggest may pose difficult political issues beyond my competence to solve. Let me therefore layout broad policy objectives without considering ways and means.

1. Filling the information gap. I have pointed out that congressional and public fixation on the problem of economic concentration in terms of competition and consumer interests has not yielded us effective weapons for dealing with the conglomerate merger movement. I have suggested that Congress and research people outside of Congress need to shift attention toward the interests of workers and community people and seek to generate nationwide information on the employment effects of the conglomerate merger movement. If research shows serious job losses resulting from mergers and divestitures, these findings will generate support in Congress and among citizens for an attack on the merger problem in terms of worker and local community interests.

While stressing the importance of congressional encouragement and financial support for research on this problem, I reject the argument that nothing should be done until more research findings are available.

We already have strong evidence to indicate (1) that our largest corporations make negligible contributions to increasing national employment and that (2) the net increases in jobs are produced primarily among small businesses. The call for research is intended to provide more systematic and specific information upon the ways in which conglomerate mergers and divestitures affect employment. Furthermore, since it will take several congressional sessions to pass any major corporate reform legislation, the information needed will become increasingly available as Congress deliberates.

2. Restricting credit for conglomerate mergers. According to Steven Rattner's "Washington Watch" (New York Times, December 11, 1978) one method of blocking conglomerate mergers is already available.

> Broad authority to control credit was given to the Administration in the 1965 Congress. According to Nancy Peters, a Federal Reserve Board member who has checked the statute, the President must first declare a national emergency and then ask the Federal Reserve to impose the controls. The FED can say yes or no. Mr. Miller (then chairman of the Board) is already on the record: "Artificial allocations are the least desirable," he said in New York last week.

It is unfortunate that the former chairman of the Federal Reserve Board and at this writing Secretary of the Treasury should subscribe to the economic mythology in this manner. Can he really mean that natural and self regulating economic processes are being acted out in the market places when a handful of powerful men in conglomerates, banks, and legal and accounting firms are deciding the economic fate of companies large and small?

There is a further argument in favor of such credit restriction. In an era when capital is becoming scarce in relation to urgent national needs, it should not be possible for banks to lend money for projects that are clearly non-productive. When company A takes over company B with bank loans, the transaction creates no new wealth and no new jobs. Bankers must be directed away from loans that are unproductive and guided toward loans designed to create new productive plants and equipment and new jobs.

At this writing it appears that such a credit restriction is at least temporarily in effect, through policies of the Board. Congress should act to ban such misuse of credit permanently.

3. Requiring government approval for a merger in cases where employees and community people charge that their interests are threatened by such a takeover. Consider the recent takeover of the Carrier Corporation by United Technologies. The Justice Department sought to intervene in this case but found its anti-trust weapon ineffective. In Syracuse, the headquarters city of Carrier, there was widespread alarm and popular mobilization to combat the takeover. Local businesspeople who had dealt for years with Carrier feared that this business would be moved out of town. Community leaders testified regarding the important community service roles that had been played by executives of Carrier and the importance of the corporation's financial contributions to community causes. Leaders of the United Auto Workers testified that their union enjoyed much better relations with Carrier Corporation than it did with United Technologies and expressed their fears of deterioration in labor relations if the takeover succeeded.

United Technologies sought to answer these arguments with advertisements in Syracuse newspapers, but this was simply a public relations maneuver, having no effect on the outcome of the case. Harry Gray had offered stockholders a substantial premium above the market price at the time the tender offer was announced, and it was only the stockholder interests that counted.

I recognize the reluctance of Congress these days to impose further regulations on business or indeed on any sector of our society. Nevertheless I would argue that regulation is necessary in this case, for big business has no capacity for self-regulation. In fact, as we have seen, the system operates to stimulate mergers. Opponents of what I propose will sound the bugle call of free enterprise and attack any measure that would disrupt the interplay of "natural market forces." I must point out that, as I have described it, the conglomerate-merger-divestiture game is in a different world from the free and competitive market place visualized by classical economists. Furthermore, we should recognize that corporations are not part of some natural order created by God. They come into existence only when and if they have been chartered by government (in the United States, by state governments) and are given certain privileges, such as the right of limited liability, on the assumption that, in serving the interests of their stockholders, they are also serving the broader interests of society. When it becomes apparent that in many cases the interests of the stockholders conflict with the interests of workers and community people, then organized groups of workers and community people should be able to challenge this threatened takeover. The federal government should have the authority to block such takeovers, where they are protested, and to make a final determination, taking into consideration worker and community interests as well as those of the stockholders.

I am not proposing a procedure and a set of regulations designed to block all mergers. In many cases, especially when the leaders of the two companies agree on a friendly merger, they may be able to demonstrate to the satisfaction of community leaders and worker representatives that the proposed merger is in their interests as well as in the interests of the stockholders. Furthermore, if Congress deems it essential to avoid overly severe restrictions on freedom of action of corporate leaders, Congress can even require that a proposed merger be allowed to be consummated unless a very strong community and worker case can be made against it.

4. Worker and community protection. Previous points dealt with measures designed to limit or block the mergers. We now turn to measures that may be taken to provide some protection for workers and community people in the case of conglomerate divestitures and plant shutdowns.

Timely information is of vital importance if the people principally affected are to have an opportunity to act to avoid the damage or to cushion its effects. This must involve some requirement for the conglomerate to inform workers and community people of the shutdown decision well in advance of its expected date. How long a lead time it is reasonable to impose on the corporation is a legitimate matter of debate, but the need for some period of advanced warning is hardly debatable. Research has shown that when workers and community people have sought to save the jobs through buying the plant, they have had to operate under heavy time pressures, and a number of such efforts appear to have failed primarily because time ran out before the organizers of the new firm could meet the financial, legal, and technical requirements.

Severance pay is of great importance to provide some financial cushion to enable workers to support their families while trying to find other jobs. Furthermore, a legal requirement for severance pay can serve as an inducement to the divesting corporation to consider seriously the possibility of selling the plant to employees and community people, since the legislation can be written so as to relieve the divesting corporation of its financial obligation if the jobs are maintained under new ownership.

Severance pay is an old idea which long ago was written into legislation in a number of European countries and is found in about a third of current labor contracts but so far has reached the point of legislation only in the state of Maine. Severance pay from the corporation to the affected community is a new concept, which is generating increasing interest in state legislatures as well as in Congress. Justification is based on the fact that a plant shutdown imposes damages on the local community as well as on the workers who are laid off, and therefore the community is entitled to some kind of compensatory pay. Furthermore, recent experience with economic development districts, county industrial development agencies, and community labor-management committees demonstrates that such locally based programs have the capacity to generate jobs in the private sector and also to make existing jobs more secure by providing financial and technical assistance to local firms.

Protective measures such as these are included in legislation introduced into the Senate by Harrison Williams (S. 1609: Employee Protection and Community Stabilization Act of 1979) and in the House by Representative William Ford (H.R. ???: National Employment Priorities Act of 1979, a re-drafting of a bill introduced by Mr. Ford and then Senator Mondale in the 94th Congress).

The most far reaching legislation designed to save jobs through employee or employee-community takeovers of divested plants is found in H.R. 2203, The Voluntary Job Preservation and Community Stabilization Act introduced by Congressmen Peter H. Kostmayer, Stanley N. Lundine, and Matthew F. McHugh. While this bill has not advanced beyond committee consideration in Congress, the ideas and information behind it have generated such interest as to enable its supporters to insert the key employee ownership clauses into S. 914 and H.R. 2063, the National Public Works and Economic Development Act of 1979. At this writing, both bills have passed and are expected to become law following deliberations of the Conference Committee and signing by the President.

S. 388 and H. R. 3056, the Small Business Employee Ownership Act, has passed the Senate by unanimous consent and is expected to receive House approval and signature of the President in the near future. This Act directs SBA to cease discriminating against employee owned firms and employee stock ownership trusts in its loan and loan guarantee policies. The National Consumer Cooperative Bank, now getting itself organized, is authorized to utilize 10% of its funds to provide loans and technical assistance to employee owned firms established in the form of worker cooperatives.

Worker protection and employee ownership legislation is rapidly gaining ground in a number of state legislatures. In the summer of 1979, Michigan became the first state to pass a law directing the state government to provide information and technical assistance to those attempting to establish employee or employee-community owned firms.

While I applaud these growing efforts at the state level, since big business is not limited by state lines, it is important that the federal government assume leadership in worker and community protection through conglomerate merger legislation.

APPENDIX FF.—STATEMENT FROM THE MIDWEST REGIONAL OFFICE OF THE U.S. COMMISSION ON CIVIL RIGHTS

UNITED STATES COMMISSION ON CIVIL RIGHTS
WASHINGTON, D.C. 20425

STAFF DIRECTOR

FEB 29 1980

Honorable Berkley Bedell
Chairman
Committee on Small Business
Subcommittee on Antitrust and
 Restraint of Trade Activities
 Affecting Small Business
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Bedell:

Pursuant to your request of January 23, 1980, enclosed is a brief statement of Dr. Gregory D. Squires, Equal Opportunity Specialist, Midwestern Regional Office of the U.S. Commission on Civil Rights. The statement concerning how conglomerate mergers affect minority employment is submitted for inclusion in the record of your hearing on the microeconomic effects of conglomerate mergers. Dr. Squires prepared this statement as an excerpt from some of the research and analysis underway in an Illinois Advisory Committee study of economic dislocation and its effects on minority employment.

As you are aware, the U.S. Commission on Civil Rights is an independent, bipartisan, fact-finding agency with the authority to study and collect information concerning legal developments constituting discrimination or a denial of equal protection of the laws under the Constitution because of race, color, religion, sex, age, handicap, national origin, or in the administration of justice.

The Commission has an advisory committee in each state and the District of Columbia. Dr. Squires' statement is based on his work with the Illinois Advisory Committee to the Commission. If you have questions regarding the Commission, the Illinois Advisory Committee's study or the enclosed statement you may contact our Congressional Liaison Division (Lucy Edwards at 254-6626). Dr. Squires of course can be reached at our Midwestern Regional Office in Chicago.

Sincerely,

LOUIS NUNEZ

Enclosure

CONGLOMERATE MERGERS, ECONOMIC DISLOCATION, AND EQUAL OPPORTUNITY

Statement prepared by Gregory Squires, Equal Opportunity Specialist, U.S. Commission on Civil Rights, based upon preliminary research for a report by the Illinois Advisory Committee to the Civil Rights Commission. The views expressed do not necessarily reflect those of the Advisory Committee or the U.S. Commission on Civil Rights.

Submitted to the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business, Committee on Small Business, U.S. House of Representatives.

The adverse affects of plant shutdowns and relocations on minority employment is the focus of an investigation currently being conducted by the Midwestern Regional Office of the U.S. Commission on Civil Rights and the Commission's Illinois Advisory Committee. The devastating impact of the shutdown of a community's major employer has been the subject of much public policy debate and scholarly research in recent years. The civil rights implications of such developments, however, have been virtually ignored, though our preliminary research suggests that the impact on minority job opportunities is substantial. The nation's minority population is concentrated, and is increasing its concentration, in those areas of the country experiencing economic decline or relatively slower economic growth (i.e., central cities and the Northeastern states) while the proportion of minorities is declining or remaining constant in the faster growing areas (i.e., suburbs and the South). Minority workers are concentrated in those industries and occupations which are hardest hit by recent patterns of uneven economic development within the United States. And minorities are hardest hit by the exploration of jobs to foreign shores and the increasing investments of American based corporations in other nations.[1] While no Federal laws or regulations directly address the disparate impact on minorities of plant shutdowns and relocations, a number of civil rights legal experts have made a compelling argument that violation of Title VII of the Civil Rights Act of 1964, Executive Order 11246, and other Federal requirements occurs when a relocation adversely affects minority employment and no corrective action is taken to mitigate that impact.[2] Staff members of the U.S. Commission on Civil Rights are currently examining a variety of proposals to eliminate the disparate impact on racial minorities resulting from plant closings and relocations which violate Federal equal employment opportunity requirements.

In the course of its investigation, Commission staff has found that, contrary to popular belief, plant closings and relocations do not occur simply because an employer is losing money. Frequently, quite profitable plants are closed or relocated. Conventional economic wisdom tells us that the phenomena of plant closings and relocations constitute natural and inevitable readjustments in a normally functioning market system, readjustments that will result in the most efficient utilization of the nation's resources redounding to the benefit of society as a whole.[3] Yet a growing body of research has demonstrated that the economic dislocation experienced by many urban areas and the northeast in general has resulted from a number of non-market factors as well as market considerations. Government expenditure, taxation, law enforcement, and regulatory activities at all levels have contributed to recent patterns of economic development and the adverse affects on minority employment.[4] Life style preferences of corporate executives have been shown to influence business location decisions.[5] Other factors which may be market related (i.e., affect the profitability of one or more private businesses) but which clearly conflict with overriding public welfare considerations, also affect capital mobility. For example, two factors which have encouraged many employers to move South are lower labor costs resulting in part from less union activity and fewer government regulations,[6] each of which can increase cost and reduce profits. But to the extent that unions and government regulation provide safer environments in which to work and live, lower profit margins might be justified from a public welfare perspective. In other words, the dictates of the market are not the only factors which account for uneven economic development, and when market factors do enter in, there are often many adverse social policy implications.

A critical factor which has contributed to the shutdown and relocation of many economically viable operations, to the severe detriment of the employees and the community in general, has been the conglomerate-merger developments of the late 1960's and 1970's. According to Mark Nadel of the Government Accounting Office, the conglomerate merger movement reached its peak between 1967 and 1969 when an average of 3,500 mergers occurred annually. This trend has continued, though at a slower rate, since those years.[7] Often a conglomerate will acquire a viable firm, and for reasons having nothing to do with the profitability of that particular firm, will choose to or be forced to shut it down a few years later. In some instances, the firms (and the jobs involved) have been saved by new management.

In the late 1960's, for example, one conglomerate bought out several viable New England firms, and then set a requirement on all subsidiaries that they generate a 25 percent pre-tax return on investment each year in order to generate the cash required to meet the growth plans of the parent, which happened to be located in the South. The average rate of profit in this particular industry at the time was between 7 and 8 percent. Several of the subsidiaries were subsequently closed, costing approximately 4,000 New Englanders their jobs. As MIT economist Bennett Harrison concluded, "There is nothing especially 'natural' about being unable to do three to four times better than your competition."[8] And there is nothing unique about such requirements. Increasingly conglomerates are discarding divisions and throwing people out of work, not because they are unprofitable but because they are not sufficiently profitable to meet an arbitrary overall company goal.[9]

Other cases have had happier endings. In 1976 Sperry Rand announced that it would be liquidating its Herkimer, New York library furniture factory, in part because the factory was not generating a 22 percent return on invested capital, the standard used by Sperry Rand as an acceptable rate of return. The 270 jobs at the Herkimer factory were saved when a group of community residents, including many of the workers, organized to buy the facility from Sperry Rand. The factory has long been profitable, generating a profit in every year except one during the twenty years it was owned by the conglomerate. And there is reason to believe that the Mohawk Valley Community Corporation, as it is now called, will be even more profitable under independent management. Under Sperry Rand the furniture factory had its own sales force but was prohibited from calling on other Sperry Rand customers. In addition, foreign sales could only be secured through the conglomerate's international division.

These two marketing barriers have since been removed, and as a result millions of dollars in sales are being generated from new customers.[10] In several other cases, transfer of ownership from conglomerates to independent local organizations often involving worker ownership and control (though in widely varying degrees) has either turned a losing proposition into a profitable one or kept a viable operation from closing, while saving hundreds of jobs in the process. Examples include the Saratoga Knitting Mill (N.Y), Jamestown Metal Products (N.Y.), Vermont Asbestos Group, South Bend Lathe Company (Indiana), Chicago and Northwestern Railroad (Illinois), Okonite Company (New Jersey), Sea Pack Corpotation (Georgia and Texas), Bates Fabric (Maine), and Pacific Paperboard Products (California and Oregon).[11]

Unsound and occasionally illegal accounting practices by conglomerates have also contributed to plant closings and job losses. Through a variety of paper manipulations (what John Kenneth Galbraith has labelled "creative accounting") some conglomerates have inflated the value of their stock. Funds obtained through the sale of inflated stock are then utilized to purchase more companies. If the worth of each subsidiary has been systematically exaggerated, and if the parent has been utilizing cash from its subsidiaries to finance its own operations or the purchase of more subsidiaries, eventually these companies will become financially unsound. As Harrison argued, this process amounts to a parent corporation disinvesting in its own subsidiaries.[12]

The now infamous shutdown of Youngstown's Sheet and Tube Company is an example. Lykes Corporation, the New Orleans based conglomerate which purchased the Ohio steel company in 1969, attributed the eventual closing of the plant to cheaper imports, costly environmental regulations, and government price restraints.[13] But other factors were working as well. Lykes borrowed heavily to purchase the steel factory which was worth six times what Lykes itself was worth at the time. Although the steel factory was generating a profit for Lykes, the conglomerate used those profits to pay off its initially high debt, which increased as it continued to make further acquisitions. Little was reinvested in the steel plant so Lykes was unable to take advantage of the steel boom of 1973 and 1974. The recession which followed left Lykes with insufficient funds to modernize the facility so that when the closing was announced shortly thereafter, the plant was obsolete.[14] The closing of Youngstown's Sheet and Tube Company was not the result of natural market forces or unexpected developments in the way of foreign competition or government regulation. Before Lykes purchased the plant the Anti-Trust Division of the Department of Justice issued a study advising against the merger. The reasons were that the takeover would leave Lykes so heavily in debt that it would not be able to finance the modernization necessary to keep the Youngstown operation competitive. The study predicted that if the merger were to proceed Youngstown Sheet and Tube would be shut down within ten years. The prediction was off by one year.[15]

While some corporate officials may view mergers, divestitures, as well as shutdowns, as part of the inevitable workings of a market system which, in the long run, redounds to the benefit of the nation as a whole, others are not so benign. Walter B. Kissinger, Chief Executive Officer of the Allen Group Incorporated, a company listed on the New York Stock Exchange, stated:

> As a result of takeovers, more than 100 public companies lost their independence in the course of 1977, causing great destruction and waste for their managers and employees and for the communities in which they operate. More than 20 billion dollars of corporate cash resources that could have been used to create new production and employment opportunities will instead have been devoted to rearranging the ownership of existing properties.[16]

In addition to "creative" accounting practices, the Federal Trade Commission (FTC) noted that businesses frequently take advantage of Federal tax policies which provide incentives for mergers that are unrelated to economic efficiency or any other social utility.[17] According to the FTC, "Rather than exerting a neutral influence, current tax laws actually subsidize mergers.[18] While citing a number of provisions in the Federal tax code which provide such incentives, the FTC noted one in particular, the nonrecognition for tax purposes of gains associated with corporate reorganization. When an acquisition results from an exchange of stock, rather than from an outright purchase, the acquisition is considered a mere change in capital structure rather than a capital gain. Thus there is no capital gains tax. The FTC estimated that the lost tax revenues resulting from this provision may have exceeded $1 billion in 1968.[19] The merger movement of the late 1960's and the increasing concentration of industrial assets, subsidized in part by Federal tax policies, led the FTC to conclude:

> These interrelated developments pose a serious threat to America's democratic and social institutions by creating a degree of centralized private decision-making that is incompatible with a free enterprise system, a system relying upon market forces to discipline private economic power.[20]

The economic dislocation caused by plant closings and relocations creates many problems that will have to be faced by public officials at all levels. It can no longer be assumed that uneven economic development is simply a manifestation of a benevolent free market. At least some dimensions of the conglomerate-merger activity of the past two decades illustrates the socially dysfunctional sides of capital mobility. One of the most serious problems created in the wake of such mobility and dislocation is the apparent further disparate restriction of job opportunities for the nation's minority population. Upon completion of the investigation by the Illinois Advisory Committee and the Midwestern Regional Office, specific recommendations may be transmitted to the Commission. It is anticipated that these recommendations will be designed to ameliorate disparate impact on racial minorities resulting from plant closings and relocations.

1. Illinois Advisory Committee to the U.S. Commission on Civil Rights, Shutdown: Economic Dislocation and Equal Opportunity (forthcoming, 1980).

2. Alfred W. Blumrosen, "The Duty to Plan for Fair Employment: Plant Location in White Suburbia," Rutgers Law Review, Vol. 25, No 3 Spring 1971. Suburban Action Institute, "Petition to the United States Department of Labor for a Ruling That Union Carbide is in Violation of Federal Contract Compliance Requirements Pursuant to Executive Order 11246," 1977. Equal Employment Opportunity Commission Memorandum, Congressional Record - Senate, February 22, 1972, pp. 4925-2926.

3. Richard B. McKenzie, Restrictions on Business Mobility: A Study in Political Rhetoric and Economic Reality (Washington, D.C.: American Enterprise Institute 1979).

4. The State of the Region: Economic Trends of the 1970's in the Northeast and Midwest (Washington, D.C.: Northeast-Midwest Institute and the Northeast-Midwest Coalition, 1979). Jeremy Rifkin and Randy Barber, The North Will Rise Again: Pensions, Politics and Power in the 1980's (Boston, Beacon Press, 1978). (Hereafter cited as The North Will Rise Again). U.S. Commission on Civil Rights, Equal Opportunity in Suburbia, 1974. Edward Kelly, Industrial Exodus (Washington, D.C.: Conference on Alternative State and Local Public Policies, 1977). Jack E. Nelson, "The Impact of Corporate Suburban Relocations on Minority Employment Opportunities," a research paper prepared under contract with the Equal Employment Opportunity Commission, Contract No. EEO73022, 1974.

5. David Birch, "The Job Generation Process," MIT Program on Neighborhood and Regional Change, 1979.

6. The North Will Rise Again, p. 63.

7. Mark Nadel, Corporations and Public Accountability (Lexington, Mass.: D.C. Heath and Company, 1976) p. 122. Ritchie P. Lowry, "A Sociological View of Corporate Mergers," Paper presented at the 29th Annual Meeting of the Society for the Study of Social Problems, Boston, August 27, 1979.

8. Bennett Harrison, "Testimony in Support of the Notification and Assistance Act (S-127)" before the Joint Committee on Commerce and Labor, Massachusetts General Court, p. 4. (Hereafter cited as Harrison testimony).

9. Daniel C. Schwartz, Deputy Director, Bureau of Competition, Federal Trade Commission, "Merger Enforcement and the Failing Company Defense," statement before the Subcommittee on Antitrust, Monopoly, and Business Rights, Senate Committee on the Judiciary, July 19, 1979.

10. Daniel Zwerdling, Democracy at Work (Washington, D.C.: Association for Self-Management, 1978) pp. 72-76.

11. Peter H. Kostmayer, "Employee-Community Ownership to Save Jobs When Firms Shut Down," Congressional Record - House of Representatives, June 19, 1978.

12. Harrison testimony, p. 6.

13. John Collins, "Save Youngstown, Save America," Church & Society, July-August 1978, p. 11.

14. David Moberg, "Shuttered Factories, Shattered Communities," In These Times, June 27-July 3, 1979, p. 13. Gar Alperovitz and Jeff Faux, "The Economics of Urban Reconstruction," Church & Society, July-August 1978, pp. 26-34.

15. William Foote Whyte, letter to Isabel Sawhill, Director, National Commission for Employment Policy, July 17, 1979.

16. New York Times, January 22, 1978.

17. Federal Trade Commission, Economic Report on Corporate Mergers (U.S. Government Printing Office, 1969) pp. 142-159. (Hereafter cited as Corporate Mergers).

18. Corporate Mergers, p. 142.

19. Corporate Mergers, p. 146.

20. Corporate Mergers, p. 5.

APPENDIX GG.—STATEMENT SUBMITTED BY KENNETH C. WAGNER, MISSISSIPPI RESEARCH AND DEVELOPMENT CENTER

RESEARCH AND DEVELOPMENT CENTER

April 11, 1980

Mr. Mark Levine
Small Business Administration
Rayburn House Office Building B-363
Washington, D. C. 20515

Dear Mr. Levine:

I'm sorry our involvement in our ongoing legislative session has delayed completion of the enclosed statement. I hope it may still be of use to you.

I decided to address the job loss problem as it appears to me to result not only from mergers and acquisitions but other causes. I feel strongly that the basic problem that is generally overlooked is that plants are often closed down or moved as a result of poor management of local resources — the same management problem that prevents healthy growth in many locations.

I then tried to briefly describe the basic approach required to address any job development problem. Finally, I have listed some of the tools and techniques we use here at the Center. We will be teaching economic developers across the south (and possibly elsewhere in the country) many of these techniques through the EDA workshop program mentioned in the paper.

If I can provide additional information on anything discussed in the paper, please let me know. I should be able to respond much more quickly to any subsequent request.

Sincerely,

Ken Wagner

Kenneth C. Wagner
Director

KCW:et

Enclosure

JOB LOSSES AND SOLVING JOB NEEDS

by

Kenneth C. Wagner

Although not affected as much by job losses from acquisitions and mergers as many other states, Mississippi has suffered the same sort of job losses from other causes, such as military base closings. Problems caused by severe job losses are the same, whether through merger, business failure, removal of a low wage plant to a still lower wage foreign country, or even the displacement of thousands of farm workers from mechanization.

A program that Mississippi has developed to solve its cities' job needs can be used to solve the problems of communities that have lost large numbers of manufacturing jobs from mergers and acquisitions. The problem is -- how to create new jobs. The system needed to solve the problem is the same, whether jobs are needed to replace lost jobs or to add to an existing economic base. It makes no difference if that base is (1) healthy and thriving, (2) underdeveloped, or (3) suffering from a serious loss caused by mergers and acquisitions.

It's important to recognize what the problem is not. The problem is not one of trying to keep unnecessary military bases open or to prevent farmers from replacing farm workers with machines. Nor is it to force companies to maintain existing facilities when they need to reduce or close down a facility to maintain their profitability. Manipulations of this sort can destroy the financial foundations of the companies involved and will quickly wreak havoc with our entire economic system. A company operating under a free enterprise system has to be able to make a profit. If it is forced to maintain unprofitable operations, consumers and taxpayers will pay for the artificial manipulations and extra costs.

The need is to confront the real problem -- job development. Problems caused by mergers and consolidations may be different in some ways from problems caused by the relatively few cases where companies shut down operations because of the obsolescence or high cost of existing plants. But in either case, whether the community setting is an economically healthy one or whether it is a poor location, it may make sense for a parent company to merge a newly acquired plant with newer or better located operations.

The task is the same, whether the community provides a healthy economic setting or whether it has many economic liabilities and may need to carry out an extensive community redevelopment program. That task is to create jobs to replace jobs that have been lost. Whatever the cause of the loss, there are certain basic steps that need to be taken. And the steps required to replace jobs are basically the same as the steps required to add jobs to a thriving area or to an underdeveloped area.

Areas seeking to create jobs need to work through the following steps:

1. Identify companies already in business locally that have growth potential -- and take any steps needed to help speed their growth.

2. Identify and develop opportunities for establishing new "home-grown" companies to fill gaps in the existing economy.

3. Identify and develop opportunities for attracting new payrolls from outside the area -- whether manufacturing, distribution, headquarters or other operations -- whatever fits the local resource situation.

4. Identify every problem or deficiency that may be holding back the area's growth and determine what action is needed to solve each problem.

5. Carry out a systematic action program to clear the way for healthy economic growth.

Each of these five steps may involve many tasks, depending on local circumstances. But it's important to note that in most cases a knowledgeable, experienced development specialist can identify an area's major problems and at least some of the major potentials in no more than two or three days. In smaller cities it can often be done within 24 hours. Corrective action can then quickly be initiated on priority problems.

This is not to minimize the complex problems often involved. It is to say there is no need to wait months for special studies before initiating work on serious problems that obviously need attention.

The fact is that the difficulties faced by most communities across the nation -- large or small, North or South -- stem directly from poor management. Many cities are unattractive to investors because their tax structures are out of control. Many are unattractive because their facilities and services have run down and they can no longer efficiently provide support services to companies that need them. Such neglect often contributes to high taxes when steps are finally taken to correct deficiencies. If our cities, large and small, cannot face up to the problems they have as a result of poor management in years past, then they can expect additional difficulties as more companies find it impossible to operate profitably in their areas and either curtail or shut down existing operations. And move more operations to other countries.

Patching up a bad situation is often the worst thing that could be done. We have done this too long, to the detriment of good management and the attitudes necessary for this country to grow in a healthy manner. Giving grants and subsidies to cities that have not done their homework produces the same result as buying junior a new bike after he has left the old one out in the rain to rust and deteriorate so that he can no longer ride it. Junior learns nothing -- except to continue to neglect his possessions and that "daddy" will buy a new bike if the old one becomes useless as a result of junior's neglect.

A prime problem we have found in Mississippi is that local governments often fail in their responsibility to produce the local revenues needed to maintain the facilities and services required to encourage investors. The reassessment of property and equalization of taxes in virtually every case would produce the revenues required to make needed community improvements.

A dramatic change in attitudes and values during the last 20 to 25 years needs to be reversed if we are to enjoy healthy economic growth in the years ahead. Twenty years ago in Georgia, when I was directing an economic development program at the Georgia Tech Engineering Experiment Station, it was possible to go into almost any small community of 2,500 persons or more and within a few weeks to raise $100,000 to $200,000 to acquire land needed for an industrial site.

This attitude no longer exists. The current attitude is reflected by a recent experience in a small community in Mississippi. Some 30 local leaders met to discuss buying land for a new industrial park. Their sole concern was to find which federal program could provide the funds. More important, they are possibly going to lose two manufacturing plants in an existing industrial park because they have failed to solve a water pressure problem. Why? They are waiting for federal funds. They could easily raise the money locally. Instead, because of their now deeply ingrained habit of waiting for federal funds, they stand a chance of losing more than 300 jobs -- a loss that would set the local economy back severely.

This is the problem that faces America: We have gotten away from good business practices and good resource management. The question of what, if anything, to do about the economic impact of the shutdowns that occur when mergers and consolidations take place is only one facet of a broader problem. The real problem is how to create jobs in a healthy fashion -- whatever the circumstances that create a job need.

Until a systematic effort is made to rebuild the deteriorated economic foundations of many of our cities, we can expect one city after another to experience the traumas that have been felt in recent months by New York City, Buffalo and others that have let resource management problems get out of hand. Federal subsidies and federal restrictions on the movement of companies that require mobility in order to profit and survive are not viable solutions. In many cases they will create additional problems, not only for cities but also for the companies by postponing treatment of local resource management ills.

The steps outlined above require local leaders to give attention to problems resulting from neglect, poor management, and politics. It takes time to correct problems that have developed over 10 or 20 or more years. In the biggest job of this sort we have tackled -- a city of 175,000 -- it took five years of tough, grubby work to clean up and fix up the results of many years of poor management. But in the sixth year, the pay-off came -- 3,300 new, relatively high wage manufacturing jobs -- more than the area had gotten in the preceding 15 years.

Many practical tools and techniques are available. Among those used by the R & D Center are:

- Three films produced by the Center that describe what it takes for healthy economic growth. The films, a published Economic Development Manual and a simulation game provide materials for a "Planning for Growth" workshop for local officials and civic leaders. Sixteen organizations in 10 states (in addition to Mississippi) are now using these materials.
- A wide range of management, planning, and technical services help local officials with analysis of financial problems, tax problems, water and sewer, zoning and land use, community appearance, etc.
- A wide range of management and technical services help manufacturers expand and diversify -- aid in securing capital, help with management, plant layout and production problems, recruitment and training, etc.
- Workshops help would-be entrepreneurs learn skills they need to survive and prosper.

best copy available

- Workshops help people already in business with cash flow, inventory control, purchasing, and other problems.

At present we are developing (under contract with EDA and with subcontracts to the University of Arkansas and Georgia Tech) workshops for industrial development practitioners. Through these we hope to impart new skills and better perspective to people now directing economic development programs.

This fall, in collaboration with the University of Southern Mississippi, we will launch a master's degree program in economic development to provide more in-depth training for people who are interested in the management of economic resources. Both an internship and thesis will be required.

With such tools and techniques any economic development problem can be solved. But no development problem of any consequence can be solved until the essential first steps have been taken: (1) the identification of the real problems holding back healthy economic growth in an area, and (2) implementation of a hard-hitting action program designed to systematically address each deterrent or obstacle to economic growth.

New legislation or government action to prevent job reductions necessary for profitable business operations will not only fail to solve existing problems but can be expected to create new problems worse than the old ones.

APPENDIX HH.—ARTICLES BY D. C. MUELLER

EXHIBIT 1.—"THE EFFECTS OF CONGLOMERATE MERGERS"

file: Business: Antitrust/Competition/Mergers

Vol 1 #4 Dec.

Journal of Banking and Finance 1 (1977) 315-347. © North-Holland Publishing Company

Vol. 2 #4 December 1977

THE EFFECTS OF CONGLOMERATE MERGERS

A survey of the empirical evidence

Dennis C. MUELLER*

1. Introduction

The United States has experienced 3 large merger waves within the last century. Each has coincided with a period of strong economic and stock market advance. Each has come to an end along with the collapse of these bull markets and the recessions or depression that followed. The positive relationship between merger activity and stock market and economic advance is one of the well established if unexplained riddles of this literature [see, in particular, Nelson (1959, 1966); Reid (1968); and Beckenstein (1977)].

The first major merger wave has been described by Stigler as a wave to create monopolies; the second a wave to create oligopolies (1950). The third might be called a wave to create conglomerates. For the distinguishing feature of the mergers occurring in the 1960s was certainly the extent to which these mergers tended to diversify or extend the acquiring companies' product mixes.

Reid, Markham, and Steiner have all noted that many of these mergers were not between firms as unrelated in their business activities as the word 'conglomerate' or some of the literature discussing them might imply.[1] Their point is well taken. Nevertheless, a substantial difference does exist between the acquisitions characteristic of this most recent period, and the ones which brought the Standard Oil Company and General Motors together, in terms of both their potential market power advantages, and their potential for plant and production economies, as all observers of the recent wave have admitted. This difference has made it difficult to explain conglomerate mergers in terms of the market power and economic efficiency advantages that have traditionally been put forward as the motives behind mergers. Not surprisingly therefore a new set of hypotheses about the causes (and effects) of mergers has appeared to explain this new form of merger.

---

*This paper was written while the author was research fellow at the International Institute of Management, Berlin. Thanks are due for the support of this Institute and the helpful comments of John Cable, John Hiller, Thomas Hogarty, and Lee Preston.

[1] Reid (1968, pp. 74-77), Steiner (1975, pp. 17-22). These two books also present useful surveys of the earlier merger waves and the statistics on each. See, also Markham (1955, 1973).

This set is so large, however, that it is impossible to cover adequately both the recent theoretical literature on the causes of mergers, and the empirical evidence in support of these hypotheses. Fortunately, the former task has been admirably accomplished by Peter Steiner (1975). Thus, we are free here to focus upon the empirical literature, following a very brief review of the alternative hypotheses (section 2). Following this we review the empirical literature (section 3). Section 4 examines the evidence linking mergers to overall concentration changes. The last section draws the policy implications emerging from this review.

Although all Western countries experienced merger waves in the 1960s, and the conglomerate merger has been increasing in popularity in other countries too, it remains the dominant form of merger only within the U.S., and therefore we shall concentrate most of our attention on the literature concerning this country.

2. Hypotheses

It is convenient in reviewing the hypotheses about mergers to group them into those which predict that mergers generate profits to be shared between the two combining companies, and those claiming that mergers do not necessarily generate extra profits. The former we shall refer to as neoclassical theories of merger, since they are obviously consistent with the profit motive assumption. The latter we shall term managerial theories, since they are all based on the assumption that mergers are means by which managers pursue objectives other than profit or stockholder welfare maximization.

2.1. *The neoclassical theories*

Given the lack of a direct productive or technological relationship between the partners in a conglomerate merger, recent theories of this type of merger have often focussed on some form of *financial* economy to be gained from the merger. John Lintner has summarized the arguments for 5 such financial economies (1971), and we follow him over these.[2]

(*1*) *Taxes.* Lintner lists the tax exemption of corporate reorganizations, and the use of one firm's tax loss carryovers by its partner as possible stimulants to mergers (p. 107). He notes with respect to the former, however, that 'This "tax free" treatment . . . is not a positive incentive *relative to* continued independent operation.' [See, also, Sherman (1972).]

(*2*) *Leverage.* Borrowing costs decline with size of firm, and 'Large firms can thus refinance debt of small independent firms at lower economic cost resulting in a genuine capital gain through merger' [Lintner (1970, p. 107)].

(*3*) *Bankruptcy costs.* Both Levy and Sarnat (1970) and Lewellen (1971) have argued that mergers between companies whose income streams are not perfectly correlated reduces the profitability of bankruptcy and lenders' risk.

(*4*) *Diversification.* More generally, the pooling of imperfectly correlated income streams will produce a superior risk/return asset to the individual streams. Since the advantages of risk pooling can be achieved by individual stockholder portfolio diversification [Levy and Sarnat (1970)], this argument must be coupled with some restrictions on the stockholder's ability to form his own diversified portfolio (or buy into preformed portfolios like mutual funds) to justify mergers.

(*5*) *P/E Magic.* The argument was made that when a conglomerate acquired a firm with a lower *P/E* than its own, the market often evaluated the combined earnings of the two firms at the higher *P/E* of the conglomerate, rather than applying a weighted average of the two *P/E*'s, thus producing an instantaneous capital gain [Lintner (1971, p. 110); Mead (1969)].

(*6*) *Redeployment of corporate capital.* Oliver Williamson has emphasized the advantages of the *M*-form divisionalized organization for allocating capital [(1970, 1975), see also, Weston (1970)]. In this structure the central management moves capital from high average return, low marginal return divisions to those promising the highest marginal returns without undergoing the transactions costs of using the capital market [on these see, also, Sherman (1972)]. The conglomerates are prime examples of *M*-form organizations, and redeployment of capital in these ways was one of their stated goals.[3]

(*7*) *Replacement of incompetent managers.* Complementary to the achievement of a more efficient organizational form, conglomerate mergers are often seen as a method for replacing inefficient managements. Dewey's claim that mergers 'are merely a civilized alternative to bankruptcy or the voluntary liquidation that transfers assets from failing to rising firms' (1961, p. 257) has often been cited, and Henry Manne has generalized the argument in constructing a theory of 'the market for corporate control' (1965). In this market, firms compete for control of inefficiently managed companies via the takeover route. Thus, mergers are seen as an economical way of eliminating bad management, reorganizing corporate structures, and improving both allocational- and *X*-efficiency in the corporate sector.

(*8*) *Economic disturbances.* Michael Gort argues that mergers can be explained by the existence of economic disturbances which lead to a discrepancy between the value of a firm's assets placed on it by its managers or controlling stockholders, and the value placed on them by outsiders (1969). Gort cites three specific types of economic disturbances that are likely to produce accelerated merger activity: rapid growth, technological change, and changes in stock market values.

---

[2] Lintner actually lists 'dirty pooling' and other accounting gimmicks as one of his 5 causes, and subsumes bankruptcy costs under leverage. For further discussion of these hypotheses, see again Steiner (1975, chs. 2, 4, 5).

[3] It should be noted that there are 2 separate issues involved here concerning *M*-form efficiency. The first is whether the *M*-form organization is superior to the *U*-form for managing a given set of diversified activities. The second is whether the *M*-form efficiency gains are sufficient to justify the transactions costs of acquiring a large number of *U*-form companies to create a conglomerate *M*-form. The first hypothesis could be valid even if the second is not. It is only the second which is addressed here.

2.2. The managerial theories

The managerial theories argue that the separation of ownership from control allows managers some discretion to pursue goals other than stockholder welfare maximization. The pursuit of growth, as hypothesized by Robin Marris (1964), seems the most natural managerial goal to be satisfied via mergers [Reid (1968); Mueller (1969); Singh (1971)]. From some of the empirical results has emerged the possibility that managers may be pursuing a speculative or risk-taking motive through mergers. But we shall discuss this hypothesis after reviewing the evidence supporting it.

2.3. Motives for mergers and merger waves

One of the difficulties with several of the neoclassical motives for mergers is that it is difficult to reconcile them with the occurrence of merger waves in times of economic prosperity and stock market advance. Why should mergers to avoid the transaction costs and taxes involved in bankruptcy reach a feverish pace, during a broad, economic expansion when bankruptcies are on the decline? Why is it that the incompetencies of managers become most apparent when profits and stock prices are rising, and are immediately concealed once they begin to plummet? Nor does it seem logical that small firms should feel most compelled to merge with larger ones to obtain capital, at a time when their cash flows are likely to be high, and the demand for new equity issues is favorable.

Gort claims that his economic disturbance theory is consistent with the observed cyclic pattern of merger activity (1969, pp. 624–625). Logically, however, it would seem that valuation discrepancies would be as likely to arise in periods of rapid stock market decline and negative growth, as in periods of advance. Indeed, since stock prices usually fall faster following a boom than they rose during it, one might expect mergers to be counter cyclical under Gort's theory, and conclude, therefore, that the existing evidence runs counter to it.

Gort argues that mergers are more likely in upswings than in downturns, however, because

> when security prices are low relative to their mean value over a period of years, managers and long-term investors will tend to consider the shares of their firm undervalued. The stockholders of firms that are potential acquirers, on the other hand, can be expected to resist acquisition prices that are far above those at which the individual investor can purchase securities in the open market on his personal account. Consequently, valuation discrepancies of the type needed for acquisitions to occur will be far more frequent in periods of high than in periods of low security prices. (p. 628)

Thus the economic disturbance theory assumes that stockholders and managers base their current valuations of their company's stock on the recent past, but nonholders do not. During an upswing stockholders undervalue their company's earnings' growth, i.e. they tend to be bearish relative to nonholders. During a downswing they are again looking backwards and are bullish relative to nonholders. Personally I find this assymetry in expectations an awkward assumption, but shall not pursue the matter here. For policy purposes, the relevant question is still whether these mergers generate any net efficiency gains.

P/E magic is also compatible with a cyclic-merger pattern. In a buoyant market, the kind of optimistic expectations which are necessary to bring about this magic are most likely to be present. Conversely, when the market breaks, the accompanying switch to pessimism may produce an opposing reevaluation of *P/E*'s, and a sudden elimination of this possible advantage from mergers. If the merging companies have not achieved real efficiency gains to justify the high *P/E*'s applied to their combined earnings, downward pressure on their stock will be intensified. Note that in this case *P/E* magic is only consistent with stockholder welfare maximization in the short run. Only the stockholders who sell out before the market breaks are likely to gain from the mergers.

The managerial theory is also consistent with a cyclical merger pattern. In an upswing corporate profits and cash flows are on the rise. Where ample opportunities for growth via internal expansion are lacking, the only alternatives may be higher dividend payments or growth through merger. Faced with these alternatives, 'it is not surprising that the "expansiveness" of the businessman during periods of prosperity often expresses itself in the merger movement and larger business organizations' as Thorp noted in commenting on the 1920s wave.[4]

The constraint upon managerial use of cash flows to achieve goals in conflict with stockholder goals is the threat of takeover [Marris (1964)]. But in periods of rising profits and stockmarket values this constraint is likely to weaken as rising returns to stockholders increase their optimism and confidence in their managers. Indeed, the most serious threat of takeover may come from other firms pursuing growth. But, as Singh has shown, growth in size, if it is not at too great of a cost in profits, may offer greater protection from takeover than maximizing profits (1971). Thus, while the desire to grow via mergers may be constant over time, the means and discretion to pursue this goal are likely to be greater with a rising economy and stock market.

But, prosperity may also provide a more conducive environment to consummate mergers in pursuit of some of the above listed neoclassical goals. Thus, a choice between these competing explanations must rest on an examination of their effects. If conglomerate mergers prove to be largely profitable ventures, we shall return to reexamine the set of neoclassical theories to see which is most compatible with the other evidence on their characteristics. If they are not profitable, we shall reexamine the managerial theories.

---

[4] Thorp (1931, p. 86) as cited in Reid (1968, p. 67). See also Reid's discussion of the 'environment for mergers' and the managerial thesis (chs. 3, 4, 5, 7).

3. The evidence

3.1. Early evidence predating 1960s merger wave

Several good surveys of the evidence on the first two merger waves, as well as the merger history of the late 1940s and 1950s exist, and this literature need not be reviewed here [see in particular Markham (1955); Nelson (1959); Reid (1968) and most succinctly, Hogarty (1970a)]. Most of these studies compare profit rates before and after merger, and are thus somewhat difficult to compare with the more modern approach focussing on stockholder return on equity. Hogarty (1970a) concluded his survey of the early merger history thus:

> What can fifty years of research tell us about the profitability of mergers? Undoubtedly the most significant result of this research has been that no one who has undertaken a major empirical study of mergers has concluded that mergers are profitable, i.e., profitable in the sense of being 'more profitable' than alternative forms of investment. A host of researchers, working at different points of time and utilizing different analytic techniques and data, have but one major difference: whether mergers have a neutral or negative impact on profitability. (p. 389)

This conclusion seems fair based on this early evidence. It naturally raises the question of why so many mergers have taken place, and casts some doubt on the maximization of stockholder welfare hypothesis.

3.2. The recent evidence—Mergers and profitability

The first study to test for the effects of the conglomerate merger wave of the 1960s was by Weston and Mansinghka (1971). They compared the profitability of a sample of 63 conglomerates to that of a randomly selected sample of industrials, and a combined industrial–nonindustrial sample. The most interesting comparisons are between the conglomerates and the industrials and are reproduced in table 1. In 1958 the conglomerates, or rather the 63 firms that would become conglomerates, had profit rates significantly below the randomly selected sample of industrials. After 1968, the peak year of merger activity, the conglomerates had profit rates roughly equal to those of the industrials.[5] The fourth line of the table

gives an indication of how the conglomerates financed their growth. Although their leverage ratios were on average roughly 50% higher than those of the industrials in 1958, they increased to almost double the leverage ratios of the industrials by 1968. Thus, the conglomerates financed their growth in part by an aggressive increase in their leverage ratios. The last line of the table presents the not surprising result that conglomerates grew significantly faster than the industrials during the period of heavy merger activity.

Table 1

Major results from the Weston–Mansinghka study.[a]

	1958			1968		
	Sample means		F-statistic	Sample means		F-statistic
	C	RI		C	RI	
EBIAT/Total assets	5.8	9.2	9.83*	10.4	8.5	0.44
EBIT/Total assets	8.7	16.7	17.13*	15.1	15.6	0.02
Net income/Net worth	7.6	12.6	10.52*	13.3	12.4	0.81
Debt/Net worth	95%	56%	8.19*	169%	87%	10.25*
Growth in total assets 58–68				22.8%	12.6%	16.25*

[a]Notes: *Significant at 0.01 level.
EBIAT is earnings before interest and preferred dividends, but after taxes.
EBIT is earnings before interest, preferred dividends, and taxes.
For a complete discussion of the variables see Weston and Mansinghka (1971).

To explain their results Weston and Mansinghka (1971) put forward a defensive diversification hypothesis:

> Analysis of the backgrounds and acquisition histories of the conglomerate firms suggests that they were diversifying defensively to avoid (1) sales and profit instability, (2) adverse growth developments, (3) adverse competitive shifts, (4) technological obsolescence, and (5) increased uncertainties associated with their industries. (p. 928)

This hypothesis is also broadly consistent with the findings of Melicher and Rush (1974). They compared the profitability of 61 conglomerate firms with the firms they acquired. They found that the conglomerates acquired firms significantly more profitable than themselves. Conglomerates also acquired firms with significantly lower leverage ratios than themselves, suggesting a latent debt or leverage capacity motive (p. 145). These results are in contrast to those from a sample of 71 nonconglomerate acquirers, who Melicher and Rush found acquired firms with roughly the same profitability and leverage ratios as themselves.[6]

---

[5] Holzmann, Copeland, and Hayya (1975) also found that a sample of 21 conglomerates had lower average profitability than a size matched sample of nonconglomerates for both the 1951–60 and 1961–70 periods, as well as over the entire 1951–70 period. They did not make before and after the merger wave comparisons.

Similar findings to Melicher and Rush's were obtained by Boyle (1970). He compared the profitability of firms acquired in horizontal and vertical acquisitions to that of firms acquired by conglomerates. He found that the firms the conglomerates acquired had significantly higher profits than those acquired in horizontal and vertical acquisitions. Boyle specifically tested and rejected the hypothesis that the *acquired* companies were failing at the time of their acquisition, as did Conn (1976).

Weston and Mansinghka (1971) argue their 'data are consistent with the proposition that the conglomerate firms perform the economic function of preserving the values of ongoing organizations as well as restoring the earning power of the entities' (p. 928). This conclusion seems premature. That the profit levels of firms that merge with companies more profitable than themselves rise is no surprise. Whether this activity serves a useful economic function or is simply the result of the arithmetic of averaging depends on whether some additional economies are generated by joining the different sets of companies. If the defensive diversification of the conglomerates through the acquisition of relatively more profitable firms generated real economic efficiencies, the value of the resulting enterprises should exceed the value they would have attained in the absence of these mergers. Here it is particularly important to take into account the much higher leverage ratios the conglomerates developed as part of their acquisition strategies. While diversification reduces a company's risk against a downturn for any single line of activity, increased leverage by increasing fixed interest payments increases a company's risk in the face of a general downturn in economic activity. Thus, while the pre-interest payments profits of the conglomerates may have become more stable as a result of their merger programs, their post-interest payment profits may have become more volatile over the cycle. Given their heavy reliance on debt, a key performance question about the conglomerates is how they fare over the cycle.

The first suggestion that conglomerate acquisitions did not improve economic efficiency was presented by Reid (1971) in direct response to the Weston–Mansinghka article. Lags in publishing being what they are, Reid was able to base his comment on data extending up through mid-1970, and thus include the initial phase of the collapse of the 1960s bull market, while Weston and Mansinghka's data end in 1968 when the merger wave and the stock market were at their peaks. Reid reported a drop in the average price of the Weston–Mansinghka conglomerates between the end of 1968 and mid-1970 of 56%, compared with a drop in the average price of their industrials of 37%. Perhaps more dramatic and suggesting that the conglomerates had become highly risky

---

[6] Conn (1973, 1976) found no evidence of a difference between the profit rates of acquired and acquiring firms. But while the time periods and samples of Weston–Mansinghka and Melicher–Rush heavily overlap, that of Conn's does not so his results and theirs are difficult to compare.

due to their heavy levering was the drop in their bond prices of 45.6% over this period compared to a drop in the Dow-Jones Industrial Bond average 7.8% [Reid (1971, p. 945)].

3.3. *The recent evidence—Returns on stocks*

Regardless of whether the savings from a merger take the form of a tax gain, avoiding the costs of bankruptcy, diversification economies, superior deployment of capital or for some other reason, these gains should be reflected in the rate of return on the acquiring company's stock, unless the market was capable of fully anticipating the consequences of a merger or series of mergers long before they occurred. Thus, a direct test of the efficiency effects of conglomerate mergers net of the costs (including debt issues, premiums paid, etc.) of consummating them is to examine the returns on acquiring firms' stocks.

Hogarty was one of the first to use rate of return on equity as a performance measure using a sample of 43 firms engaging in substantial merger activity over 1953–64 (1970b). He specifically avoided choosing conglomerates since his point of comparison was the average firm in the acquiring company's industry. The bulk of the merging firms in his sample performed either no better or worse than the average company in their base industries.

Weston, Smith and Shrieves (1972) estimate rates of return on equity for a sample of 48 of the 63 conglomerates in the Weston–Mansinghka sample. Unfortunately they test the performance of the conglomerates against a random sample of 50 mutual funds rather than against the Weston–Mansinghka random samples of operating companies, so the two studies are not directly comparable. They find that the conglomerates outperform the mutual funds over the 1960–69 period on the basis of risk adjusted rates of return statistics proposed by Sharpe and Treynor, and Jensen's measure of portfolio performance.

In addition to their choice of control group, the Weston, Smith, Shrieves study suffers somewhat from its choice of time period. As noted above, the substantial increase in leverage the conglomerates incurred raises questions about their risk/return performance over the cycle. The period 1960–69 consists mostly of one long upswing, and the very beginning of a sharp drop. Thus, the time period chosen may have been particularly favorable to the aggressively managed conglomerates in a comparison with the conservatively managed mutual funds. This hypothesis is reinforced by the results Weston–Smith–Shrieves report. The average β for their sample of conglomerates is 1.928, nearly double the β expected on a fully diversified portfolio.[7] Thus, a one percentage point change in the returns on a diversified portfolio would be accompanied by a nearly two percentage points change for the average conglomerate. In contrast, the average β for the mutual funds was 0.878 suggesting quite a conservative management. Thus, the conglomerates were characterized by significantly higher market risk than the mutual funds, and were in a far weaker position to ride out the impending storm in 1969.

---

[7] Brenner and Downes (1975) call into question the W-S-S estimates of β and conglomerate performance as well as those of Melicher and Rush, discussed below, on the basis of the data and statistical tests employed. Unfortunately, their call for new studies employing more refined techniques has yet to be answered, or perhaps even heard.

Table 2

Main results of Melicher and Rush (1973) (C = conglomerate sample mean; N-C = nonconglomerate sample mean; F = F-statistic).

Factors		6/66–12/71	6/66–2/69	3/69–12/71
Monthly returns	C	1.008	1.017	0.998
	N-C	1.007	1.011	1.030
	F	0.20	4.50**	11.05*
Standard deviation	C	0.102	0.099	0.105
	N-C	0.094	0.087	0.100
	F	1.95	4.13**	0.59
Beta values	C	1.330	1.322	1.204
	N-C	1.011	1.152	0.912
	F	9.00*	9.87*	4.63**
Jensen alpha	C	0.003	0.010	−0.036
	N-C	0.001	0.006	−0.002
	F	0.18	3.75	2.49
Sharpe variability	C	0.045	0.132	−0.041
	N-C	0.047	0.093	0.007
	F	0.83	1.91	4.31**
Treynor volatility	C	0.004	0.009	−0.004
	N-C	0.005	0.008	−0.029
	F	0.80	0.46	1.12

From the equation $R_i - R_f = \alpha_i + \beta_i(R_m - R_f)$, we obtain:

Sharpe variability $= \dfrac{\bar{R}_i - \bar{R}_f}{\sigma_i}$,

Jensen alpha $= \alpha_i$,

Treynor volatility $= \dfrac{\bar{R}_i - \bar{R}_f}{\beta_i}$,

where:
R_i = rate of return on equity of firm i,
R_f = risk free rate of return,
R_m = rate of return on the market portfolio.

Melicher and Rush (1973) test the performance of conglomerates against a sample of nonconglomerate firms over a period that does extend through the 'liquidity crisis' of 1970 and into 1971. Their main findings are summarized in table 2. The greater volatility of the conglomerates is again apparent. Their β values are significantly higher in both subperiods, and their standard deviations in returns are also higher in both subperiods, significantly so in the 6/66 to 2/69 subperiod. This volatility is also evidenced in the first row results presenting the average monthly returns for the two samples. For the period 6/66–2/69 covering the stock market's peak, the rate of return on conglomerate stocks was significantly higher than the average return for the sample of nonconglomerates. For the period 3/69–12/71 including the liquidity crisis and the market's initial phase of decline, the conglomerates earned a significantly lower rate of return than the nonconglomerates. Over the entire $5\frac{1}{2}$ year period the returns earned on the two stocks were nearly the same. The same conclusions emerge from an examination of the various risk adjusted measures. All 3 favor the conglomerates over the first period, two of the three favor the nonconglomerates in the second. Only one of these 6 comparisons is statistically significant, however, the nonconglomerates had a significantly higher risk adjusted rate of return than the conglomerates over the 3/69–12/71 using the Sharpe measure. All 3 statistics are virtually identical for the full period.

3.4. *Risk performance*

One of the few questions for which all of the existing evidence, and all of the authors' interpretations of their own evidence are in accord is that conglomerate mergers are not an efficient method for reducing risk. The theoretical argument for this proposition is well established [Levy and Sarnat (1970)]. Lintner's argument to the contrary assumes that stockholders are limited to fairly small portfolios. But Evans and Archer (1968) have shown that the bulk of the gains from diversification can be achieved with a portfolio of roughly 10 stocks, so the following results are not unexpected.

Smith and Schreives (1969) were the first to study the efficiency of conglomerate diversification directly. Using simulation techniques they compared the portfolio holdings of 19 conglomerates and 8 mutual funds. On average the mutual funds tended to be closer to the efficient portfolio frontier than the conglomerates.

The Weston, Smith, Shrieves (1972) study was in some ways a direct follow-up to Smith and Schrieves using data on actual conglomerate firm and mutual fund performances. As noted above, the β's for their conglomerates were more than double those of the mutual funds and they in fact reject 'diversification in a risk-reducing sense' as 'the major objective of conglomerate mergers' (p. 362). This conclusion has been further supported by several studies.

Melicher and Rush (1973) did not find β's as high as Weston, Smith, and Shrieves did, but they did find conglomerate firm β's to be significantly higher than for their nonconglomerate sample. The same was found by Joehnk and Nielsen (1974). They also tested for a change in β's as a result of mergers using both conglomerate and nonconglomerate firms. They found an insignificant effect on the β's for conglomerate companies making acquisitions. A similar result was also observed by Lev and Mandelker (1972), although their sample was not limited to conglomerate mergers. Their sample consisted of 69 companies making large acquisitions (more than 10% of their own size) over the period 1952–63. They found no significant difference between the changes in β's for acquiring firms over this period, and the changes in β's for a control group matched by industry, size, and time period.[8]

Thus, there is no evidence that conglomerate firms achieved superior risk spreading performance. Indeed, to the extent their higher β's are a result of their merger activity, the conglomerates became more risky and volatile than a comparable nonconglomerate.

Having rejected 'diversification in a risk-reducing sense' as the objective of conglomerate mergers, Weston, Smith and Schrieves go on to argue that it was the active management of the assets the conglomerates acquired that accounted for their superior performance (p. 362). This hypothesis was directly tested by Mason and Goudzwaard (1976). They compared the performance of 22 conglomerates with that of 22 portfolios of randomly selected stocks chosen to match the exact industries in which the conglomerates operated. Thus, the comparison was directly of whether the direct management of a portfolio of assets by conglomerate managers achieved significantly better performance than randomly chosen portfolios. It did not. Even after adjusting for the costs of buying and selling stocks, and paying a portfolio manager, the randomly selected portfolios had statistically higher rates of return on assets and accumulated stockholders' wealth over the 1962 to 1967 period. This result is all the more remarkable, because Mason and Goudzwaard end their comparison in 1967, the year Melicher and Rush (1973) found to be the peak performance year for the conglomerates.[9]

3.5. *Characteristics of the acquired firms*

If the benefits to the stockholders of acquiring firms are ambiguous at best, the same cannot be said for the stockholders of the acquired firms. Every study which has examined the latter has found that the stockholders of the acquired firms earn significantly higher rates of return on their shares than other shares are earning, both over the immediate period before the merger and including a reasonable period after the merger is consummated. The results seem robust to type of merger, time period, and the type of compensation the stockholders of the acquired firms accept in return for their shares [see Hogarty and Gort (1970); Lorie and Halpern (1970); Haugen and Udell (1972); and Halpern (1973)].

---

[8] The β's for acquiring firms in Mandelker's study fall significantly following the merger, but this fall seems to begin as much as 2 years before the merger takes place and does not seem directly related to the mergers. Joehnk and Nielsen (1974) note significant changes in the β's for nonconglomerate firms engaging in a single conglomerate merger over the period 1962–1969.

[9] Haugen and Langetieg (1975) follow a somewhat similar methodology, although they focus on the risk reduction effects of 59 large non-conglomerate mergers. They find no significant difference in the risk performance of the merging firms, and the matched nonmerging portfolios.

The reason the stockholders of acquired firms fare so well, of course, is that they are paid a substantial premium above the premerger price for their shares. Although estimates of the premium paid in a merger vary over a fairly wide range, the minimum average premiums that have been calculated run about 15% [see Hayes and Taussig (1967); Gort (1969); Piper and Weiss (1974); and studies cited in Halpern (1973, pp. 556–557)].

What were the characteristics of these acquired firms, which made their merger partners willing to pay such large premiums for them? As already noted conglomerates acquired firms relatively more profitable than themselves. This characteristic appears to be entirely due to the lower profitability of the conglomerates. Melicher and Rush (1974) compared two samples of 61 conglomerate and 71 nonconglomerate acquisitions. The firms acquired by the conglomerates differed only in size (being larger) than those acquired by the nonconglomerates. But, since the conglomerate acquirers were less profitable and more highly levered than nonconglomerate acquirers, the firms they acquired were relatively more profitable and less levered than themselves. Both conglomerate and nonconglomerate companies had higher *P/E*'s than the firms they acquired so that *P/E* magic was listed as a possible motive for both types of acquisitions by Melicher and Rush.

Boyle (1970) compared the profitability of 698 large firms acquired in conglomerate, horizontal and vertical acquisitions between 1948–1968. He found that the companies acquired in conglomerate mergers had profit rates somewhat higher than those acquired in horizontal and vertical mergers, and roughly equal to the average over all manufacturing.

Stevens undertook a detailed multivariate discriminate analysis of the financial characteristics of 40 firms acquired in 1966 and 40 nonacquired firms matched by size (1973). Of the initial 20 factors investigated 6 were identified as making independent contributions to explaining whether a sample firm was acquired or not: '(1) leverage, (2) profitability, (3) activity, (4) liquidity, (5) dividend policy, and (6) price earnings' (p. 152). In the second phase of the discriminate analysis, only leverage and liquidity held up as significant discriminatory variables. Acquired firms had lower leverage ratios and higher liquidity than their matched nonacquired firms. The profits of acquired and nonacquired firms were the same. Acquired companies had higher dividend payout ratios and lower *P/E*'s, although the differences in sample means were not significant. Additional evidence of *P/E* magic was obtained by Conn (1973) for pure conglomerate acquisitions over the 48–69 period, and Mead (1969).

Mandelker (1974) found that the 252 acquired firms in his sample earned significantly lower rates of return on equity than other firms over most of the period prior to their acquisition (table 2, p. 315). He interprets this to imply 'that mergers are a mechanism by which the market replaces incompetent management' (p. 324).

Smiley (1976) has come up with even more dramatic results. He estimates the decline in market value of a taken-over firm up to the date of takeover as from 50 to 60 percent of its potential maximum, and he estimates the start of this decline as occurring 10 years before takeover.

How can the results of Mandelker (1974) and Smiley (1976) indicating significant deterioration in rate of return on equity performance be reconciled with those studies indicating average profitability performance? Perhaps, they cannot. The differences may be due simply to differences in samples and time periods covered. Mandelker did not find an inferior rate of return performance for the subsample of 167 acquired firms listed on the NYSE, for example (table 6, p. 320). Since these are generally larger than the other firms in his sample, it appears that the lower than average performance of acquired firms was most pronounced among the smaller acquired companies.

Mandelker's study covers the period before the conglomerate merger wave, and includes many nonconglomerate acquisitions. Smiley's (1976) study includes the years up through 1968, but is not restricted to conglomerates. The Boyle (1970) study does suggest that a significant fraction of those companies involved in horizontal or vertical acquisitions were losing money or showing profit declines. These firms may be disproportionately represented in the Mandelker and Smiley samples.

Denis Binder (1973) also noted a change in the relative profitability of acquired firms over time. Acquired firms, which contested acquisition, were less profitable than average for the first half of the 1960s but *more* profitable over the 1965–69 period. Mandelker's, but not Smiley's, sample is restricted to firms in the first time period; Melicher and Rush's, and Boyle's samples span both periods.

But the two sets of conflicting findings can be reconciled in another way. Those studies, which have concluded that acquired firms are not badly managed, have based their conclusions on profit rate and other accounting data. Those, which have concluded they are, have based their conclusions on return on equity data. The picture of an acquired firm emerging from Boyle (1970), Melicher and Rush (1974), Conn (1976), and Stevens (1973) suggests an average (profitability, leverage) to somewhat conservatively (liquidity, dividend payouts) managed company. In a period of sustained stockmarket advance average/conservative financial policies may be under-rewarded by the market vis-à-vis more aggressive risk-oriented financial behavior. Thus, the lower return on equity and *P/E* performance of the acquired firms relative to the companies acquiring them may be explained by the former's more conservative financial policies and the market conditions fostering intensive merger activity.

This interpretation is further supported by the work of Piper and Weiss (1974) and Mingo (1976) on multibank holding company acquisitions. Piper and Weiss found that 'on average the 102 acquisitions [they] studied were breakeven investments that did not result in higher earnings per share for the holding companies in 1967 than would have been achieved in the absence of the acquisitions' (1974, p. 167). Mingo found that the only significant difference between the asset management policies of multibank holding companies and nonholding company banks was that the former held significantly riskier asset portfolios. Both studies concluded that their findings could be rationalized only in terms of a managerial or nonprofitmaximizing theory of the firm.

But further work on the characteristics of acquired firms is certainly needed.

3.6. *Premiums and merger success*

A few studies have tried to relate the success of a merger, from the point of view of the acquiring firm's stockholders, to various characteristics of the acquiring and acquired firms. The one variable that stands out above all in these analyses is the premium paid over the premerger price of the acquired company by its acquirer. The lower this premium is, the greater the likelihood that the acquiring firm's stockholders gain from the acquisition [Hogarty and Gort (1970); Nielsen and Melicher (1973); Piper and Weiss (1974)].

Although this result is perhaps not surprising, it does seem inconsistent with those hypotheses which claim that mergers take place to eliminate inefficient managements or to bring about special matchings between the merger partners. If the mergers were to eliminate incompetent managers, the size of the premium would tend to reflect the potential gains to the acquiring firms from replacing the incompetent managers of the firms acquired. There would be no particular reason to expect a merger with a premium of 30% to be more successful than one with 15%. The higher premium in the former would reflect the greater potential gains following the merger, and the higher price the acquirer was forced to pay in a competitive acquisition market.[19] Similarly, under a special matchings thesis, higher premiums would reflect greater latent synergy.

The finding of an inverse relationship between merger success and the size of premium suggests instead that acquired firms do not have special characteristics, (e.g. managements of varying qualities), which differ from firm to firm warranting different prices for each firm. Acquired companies would appear to be bundles of assets accurately priced in the market. The payment of a premium for these assets over their market value is on average at best a breakeven investment, and the smaller the premium one pays, the better the chance of doing better than breaking even.

Although Nielsen and Melicher (1973) are not able to relate differences in premiums paid to real or financial (*P/E* magic) gains *achieved through the merger*, they do find the acquiring firm's cash flow and *P/E* to be positively related to the size of the premium it is willing to pay. Together these studies of the premiums paid support rather consistently a managerial-motive thesis about mergers. The higher a firm's cash flow or price/earnings ratio, i.e. the cheaper capital is to it, the more it is willing to pay to acquire other firms. The amount it is willing to pay does not reflect post-merger gains. Indeed, the more it pays the less likely it is that the merger will be a success.

---

[19] Even in imperfect competitive markets premium sizes should reflect potential gains, if profitability is the goal, since the acquiring firm's managers and stockholders are then in [illegible] of a monopsony situation, and can hold out for a greater share of the net gains.

Unfortunately, the above studies do not deal directly with the conglomerates. One study that did, Haugen and Udell (1972), found that conglomerate acquirers paid significantly higher premiums on average than nonconglomerate acquirers, but it did not relate premium size to acquiring firm profitability.

3.7. *Studies which conclude that mergers improve economic efficiency*

The pattern of results that has emerged up to this point seems more consistent with the managerial thesis than with the neoclassical alternative. But before examining this contention specifically, let us pause to consider directly those studies which claim to have rejected the managerial motive hypothesis.

Of the recent studies examined here 5 have concluded that mergers improve economic efficiency and seem to present evidence directly contradicting a managerial thesis. These are the two papers coauthored by Fred Weston (1971, 1972), and three stemming from the Ph.D. dissertations by Halpern and Mandelker at the University of Chicago [Halpern (1973); Lev and Mandelker (1972); Mandelker (1974)]. We have already discussed the Weston et al. studies in detail and seen that their results, when extended, are quite consistent with the general pattern emerging from the full set of studies, and are not inconsistent with a managerial theory interpretation. We shall focus here, therefore, on the 3 papers coming out of Chicago.

These studies are based on similar data samples. Halpern uses a sample of 78 mergers between January 1950 and July 1965 'composed of companies for which merging is an infrequent method of growth' (1973, p. 559); Lev and Mandelker have a sample of 69 firms undertaking a single large acquisition between 1952 and 1963; Mandelker has a sample of 241 mergers from November 1941 to August 1962. Thus, none of these studies covers the period of the conglomerate merger wave nor focuses on firms engaged in numerous, conglomerate-type mergers. Nevertheless, each claims that its results contradict some of the hypotheses put forward with respect to the conglomerates, and, since they have not been reviewed before, an examination of their results and claims seems warranted.

Halpern examines the rate of return performance of both partners in a merger up until the date of the merger. He does so by regressing the rate of return of an individual firm on the market return as in the equation presented on the bottom of table 2, and then cumulating the residuals from this equation. He finds that both the larger and the smaller of the two merger partners have positive, average, cumulative residuals up through the date of the merger. But the variances are large, and neither the larger nor the smaller firms involved in these acquisitions have an average cumulative residual as large as the sample standard deviations. An interesting aspect of Halpern's study is that much of the excess returns on the

merging companies' stocks is earned in the months preceding the announcement of the merger. Halpern concludes that 'my results show that the larger company does not give away everything in a merger; the mean adjusted gain to the larger company is positive and the total adjusted gain is divided evenly, on average' (p. 572). This conclusion is stronger than warranted. As noted the positive returns earned by the acquiring firms are not statistically different from zero. In addition, since Halpern's study measures performance only *up to the date of the merger*, it is really a study of the market's *expected* gains from a merger, not of the actual gains.

The latter failing is corrected by Mandelker. He also employs a monthly-residual-approach, but extends his comparisons to up to 40 months after the merger takes place. As did Halpern, Mandelker finds a rise in the cumulative residuals of the acquiring firm up to the date of the merger (5.1 percent). Following the merger there is a drop-off in the cumulative residuals of 1.7 percent, indicating that the market was somewhat overoptimistic about the merger's success. The cumulative increase in residuals over the entire period remains positive, but the variance is again large and the average residual is not significantly different from zero.

A detailed comparison of the behavior of the returns on the acquired and acquiring firms' stocks before the merger reveals an important difference. For the acquired companies a significant and steady increase in cumulative residuals occurs over the 7 months preceding the merger indicating 'that for some mergers, positive information regarding acquisitions, or any other "good" news correlated with acquisitions, starts leaking out to the market about 7 months before the merger' (p. 314). For the acquiring firms, however, the rise in returns occurs long before the merger takes place, a phenomenon also observed by Ellert (1976). Over the 7 months preceding the merger the cumulative residuals for the acquiring firm exhibited a slight decline pointing 'to the possibility that for the stockholders of the acquiring firms, "news" of an acquisition may not be worthwhile news, since no abnormal behavior is in fact observed during the period (−7 to 0). The abnormal returns earned long before the merger may have nothing to do with the acquisition per se' (p. 321).

In fact, however, it may be the abnormal returns of the acquiring firm long before the merger which are causing the merger, rather than the other way round. The rise in returns on acquiring firms' stocks over the years preceding the merger suggests that these firms were experiencing higher than normal profits and/or *P/E*'s over this period. And it might have been this abnormal prosperity which precipitated the decision to undertake an acquisition. This interpretation is consistent with the Nielsen and Melicher (1973) findings relating high cash flows and *P/E*'s for acquiring firms to the premiums they pay, and the more general phenomenon that merger waves occur in periods of prosperity. If the rise in residuals for the acquiring firms before the merger were the cause of the acquisition, and the *fall* in residuals *following* the merger a result of it, Mandelker's [illegible] would present a more negative view of the [illegible] of mergers for the stockholders of the acquiring firms, and would be more in line with the managerial thesis than he is willing to conclude himself.

A closer look at Halpern's results suggests that they may follow the same pattern as Mandelker's and be amenable to the same interpretation. Unfortunately, Halpern does not report the monthly residual pattern for the larger and smaller of the two merging firms separately. But he does report these residuals for the two samples combined (1973, p. 567, table 2). These residuals show a noticeable rise over the period from 18 to 23 months before the merger, and again starting 7 months before the merger. If the latter reflected the gains from speculation in the to-be-acquired firm's stock, Halpern's results would correspond exactly to Mandelker's. But, it is again hard to believe that the increases in returns, being earned between a year and a half and two years before the merger were caused by the merger. Instead it is likely that there were higher returns earned by the acquiring firms, and if causality is involved at all it is these returns that created the merger. Even if the latter conjecture is false, however, it seems unjustified to include as part of the gains from mergers, increases in returns on the stocks of acquiring companies earned more than a year and a half before the merger is announced.

The 69 firms making a single large acquisition which Lev and Mandelker study earned higher average returns on their stocks over the 5 years following the merger than before, as compared with a sample of companies matched by size and industry, but again the difference in sample means was statistically insignificant. Most of the other evidence in their study was also 'largely negative.'

All three of these studies conclude that their findings are inconsistent with the 'allegations' that mergers are not undertaken to improve the welfare of the acquiring firm's stockholders, or lead to real gains in economic efficiency. Halpern and Mandelker argue more specifically that their results suggest that mergers are a means of removing inefficient managements (of acquired companies). If we ignore the question of whether high returns cause firms to become acquirers or the reverse, this is a potentially legitimate interpretation of their findings. For the mergers do appear to have generated gains to the stockholders of the acquired firms. And if they did not do likewise for the stockholders of the acquirers they also did not generate negative returns. So at a minimum the mergers appear to have generated enough efficiency gains to have benefited unambiguously the stockholders of the acquired firms. But this conclusion still raises some questions about the motives behind the mergers from the point of view of the acquiring firms.

For the mergers are not simply another form of *marginal* investment. The mergers examined in each of these 3 studies were between firms both of which were large enough to have listed securities. The acquiring firms in the Lev and Mandelker sample grew at roughly double the rate of their matched pairs over the same 11 year period, as did Weston and Mansinghka's conglomerates compared to their sample of industrials. Why should managers engage in acquisitions or series of acquisitions resulting in such dramatic increases in their company's size and perhaps character when their stockholders obtain no benefits from these changes, if the goal of the managers is to increase their stockholders' welfare? The interpretation of the Halpern, Mandelker and Lev and Mandelker findings these authors themselves give, leaves the managers of the acquiring firms as corporate good samaritans who go about bidding up the prices of badly managed firms and rescuing the stockholders of these firms from their managements, to the benefit of only the stockholders of the acquired firms. The acquiring company managers gain nothing, their stockholders a normal return.

The difficulty in reconciling normal returns to stockholders of acquiring companies, and supranormal returns to stockholders of acquired firms in a neoclassical framework is clearly evidenced in Mandelker's discussion of why it is that stockholders of *acquired* firms fair so well:

> When a firm is confronted with a tender offer a conflict of interest between management and shareholders may result. Although the stockholders of the acquired firm are likely to profit from the merger more than any other party involved, incumbent management may stand to lose the most, for they may forfeit their controlling position with all of the accompanying benefits (p. 326).

Earlier on the same page he notes that 'Indeed, it is very difficult to acquire a firm if its management resists forcefully,' citing B.F. Goodrich management's successful defeat of a merger bid that would have increased stockholder net worth by 70 percent. But a takeover fight is but a polar case and the most blatant example of a conflict of interest between managers and stockholders. And just as the existence of a separation between ownership and control can explain why managers reject merger proposals which would result in instantaneous capital gains of 30% and more for their stockholders, it can explain why managers make merger proposals resulting in no gains for their stockholders—and might even be willing to make such proposals if the stockholders suffered a loss. For the same stratagems which allowed B.F. Goodrich's management to resist Northwest Industries' $1 billion tender offer were available to Northwest Industries management should they need them, to ward off unhappy stockholders who felt that was too much to pay for the assets of the Goodrich firm.

Thus, the conclusion that the stockholders of acquiring firms earned a normal return on their companies' acquisitions, even if warranted, does not in itself settle the issue as to why the managers of acquiring companies engage in this form of investment. We turn to this issue now.

3.8. *The evidence as it relates to managerial motives for merger*

Gort has noted with respect to earlier mergers that acquiring firms tend to be located in slow-growing sectors and enter fast growing ones (1966, p. 41). This strategy is consistent with Weston and Mansinghka's defensive diversification hypothesis, as is Gort's finding that acquired firms tend to be in R and D intensive industries (1969), and McGowan's that acquiring firms are in R and D nonintensive industries (1971). These tendencies lead to a life-cycle view of the firm that is consistent with either a stockholder welfare maximization interpretation, as Weston and Mansinghka put forward, or a growth objective [see Mueller (1972); Grabowski and Mueller (1975)]. The conglomerates appear to have been located in industries in which technological maturity and competitive pressures inhibited internal growth.[11] If these firms wanted to grow fast, merger was the only feasible way. The evidence surveyed here indicates that whatever their objective, conglomerate mergers, like their predecessors, did not lead to significant improvements in the risk/return performance of the acquiring firms' stocks. Whether it was the objective sought or not, significant increases in growth were achieved via these mergers [Reid (1968); Weston and Mansinghka (1971); Mandelker (1974)].

The significantly higher leverage ratios of the conglomerates before they undertook their merger activity suggests that they did have more aggressive, expansion oriented managers than other companies. Singh also found that acquiring firms in the U.K. had higher leverage (gearing) ratios than nonacquirers, and in addition had higher retention ratios, lower liquidity, and faster growth rates (1971, pp. 160–161). Although Kuehn's results for the U.K. differ from Singh's in some respects, they are also consistent with the interpretation that acquiring company managers are more aggressive than other managers (1975, ch. 6).

Singh observed that acquired firms earned somewhat lower profits than nonacquired firms, and Kuehn observed both lower profits and valuation ratios for U.K. companies acquired (1975, ch. 3). Some studies in the U.S. from before the conglomerate merger wave have found similar patterns. But, no evidence has been gathered to suggest that acquired firms were to any degree in danger of bankruptcy, however, and the companies the conglomerates acquired were earning higher profits than themselves. Lynch has even argued on the basis of case study analysis of 28 conglomerates that they followed a strategy of acquiring 'successful, profitable companies' with 'capable management that can be retained' (1971, pp. 83–85). Indeed, to the extent that a failing-firm or alternative-to-bankruptcy motive for conglomerate mergers emerges at all from this literature, it is the acquiring firms that may be trying to improve their positions by defensively acquiring companies more profitable than themselves. This is ironic since the usual failing-firm defense of mergers has been couched in terms of rescuing acquired company stockholders from inept managers [e.g. Dewey (1961); Manne (1965)].

---

[11] A similar pattern of leverage for acquiring firms was observed by Kuehn for the U.K. (1975, pp. 18–20, ch. 4). Given the milder antitrust environment in the U.K., however, it was not necessary for these firms to go outside of their industries to achieve growth via mergers.

Several of the studies cited found that acquiring firms experienced periods of temporarily higher than normal returns preceding their acquisitions, returns that could not be in any sense 'caused' by the mergers. Nielsen and Melicher's finding that high P/E's and cash flows lead to higher offered premiums on mergers is also consistent with the view that it is 'cheap' internal and external capital which leads to mergers, capital which is cheap in the sense that management does not feel compelled to use it to maximize stockholder welfare. Beckenstein has observed a positive relationship between aggregate merger activity and the cost of external capital, which he interprets as supporting a managerial thesis (1977).

The would-be conglomerates did not have high cash flows and P/E's at the beginning of the 1960s. Nevertheless, the rise in profits and stock market values that occurred during this decade, and the relatively low interest rates prevailing throughout much of it, provided these firms with a more favorable environment to pursue growth through the most attractive avenue available to them: external expansion. The pursuit of this goal subsided at the end of the 1960s, when this environment changed.

Since growth must accompany any significant merger program, there is no way to establish whether this is the primary objective of these mergers, or auxiliary to some other(s). Space does not allow a review of all possible alternatives [but, see Steiner (1975, ch. 6)]. One does emerge from this survey, however, and since it has not received much attention in the literature it is worth discussing here.

Both Halpern (1973) and Mandelker (1974) provide evidence that the gains from mergers that do occur often come before the merger takes place or is even announced. This finding has been confirmed by Firth (1976) for the U.K. and Gagnon, Brehain, and Guerra (1976) for Belgium. Firth found a substantial rise in the stock prices for acquired firms over the 21 trading days preceding the announcement of the merger, peaking 4 days before the announcement (pp. 83–90). No change in the returns to stock on the acquiring firms was noted in this period, however.[12] Gagnon, et al. found a significant increase in the volume of trading in both the acquiring and acquired firms' stocks over the 10 months preceding a merger's announcement and concluded that information about the merger reached the market during this pre-announcement period.

None of these studies pursues the issue of who it is 'in the market' who has possession of this information about a forthcoming merger that causes an increase in trading volume and a rise, at least for the company to be acquired, in stock price. The most obvious group having access to this information is the management planning the merger. As Manne (1966) has emphasized the access to insider information is one of the important perequisites managers have. And the knowledge that the shares of a to-be-acquired firm will soon rise by 15 percent or more, is a valuable piece of information. Thus, one possible explanation for why managers engage in mergers that have no benefit to their stockholders is that the mergers provide opportunities for possible gains from insider information.[13] This interpretation also seems easier to accept than that given by Hogarty (1970b) and Gort (1970), that the managers were risktakers maximizing stockholder welfare. For much of the risks arising from a merger fall to the stockholders, and access to insider information gives managers an opportunity to share disproportionately in the gains while avoiding some of the risks.

---

[12] (pp. 142–157) Some rise was noted if the acquiring firm financed the acquisition by a new equity issue, but this was attributed to the arrangement of 'some buying support for their securities' (p. 147). Interestingly enough, the acquiring firm's stock suffered a significant decline in value in the 30 trading days following the merger's announcement.

This interpretation also raises additional questions about studies such as Halpern's (1973) that base their conclusions solely on the gains from mergers on stock price data preceding the merger. To the extent managers do undertake mergers in anticipation of a favorable stockmarket reaction to the merger's announcement, an unfavorable reaction might be expected to lead to a cancellation of the merger bid. By focusing on stock market data for only successful bids up to the time of the merger, these studies choose the most favorable time period over which to judge the 'effects' from a merger.

Studies of previous merger waves have concluded that 'promoters profits' played a significant role in explaining the volume of merger activity.[14] The promoters of the conglomerate merger wave were the acquiring firms' managers themselves. The studies surveyed here suggest that someone was profiting on the information about the forthcoming merger, before it became public. Whether this was the managers, and to what extent these profits influenced their decisions, cannot be ascertained. But the hypothesis that speculation of this type may have been a significant factor is certainly consistent with the evidence surveyed here, and the more general phenomenon that merger waves accompany stock market advances.

4. The effects of conglomerate mergers on concentration

A fair consensus exists that conglomerate mergers have not contributed to increases in industry level concentration, at least at a low level of aggregation, and have not had serious anticompetitive effects [Markham (1973, ch. 5); Goldberg (1973, 1974); FTC (1972)]. But at the same time there appears to be little consensus as to what the effects of mergers have been on overall concentration. Thus, the FTC (1969) concluded:

> There can be no doubt that mergers played a key role in increasing the share of manufacturing assets held by [the top 200] companies over the period [1947–1968]. Significantly, whereas industry growth effect played a role about equal in importance to mergers between 1947 and 1960, mergers have been almost exclusively responsible for the increase occurring since 1960. (p. 193)

While Jules Backman (1970) concluded:

> Moreover, the growth of large companies is due primarily to internal expansion rather than to mergers. Thus, between 1948 and 1968, the total assets of the 200 largest manufacturing corporations increased by $242.4 billion ... acquisitions accounted for $50.0 billion or 20.6 percent of this total increase. However, for the 10 largest companies, acquired assets were only 2.8 percent of the asset growth; for the second 10 largest it was (sic) 16.2 percent; and for the 21st to 50th largest, it was (sic) 24.3 percent. Clearly, for the very largest companies mergers have been a minor factor in their growth. (p. 122)

Surprisingly, these two sets of conclusions are not as irreconcilable as they appear. These and other similar studies have reached different conclusions because they have been answering different questions. Those studies which have attributed a substantial fraction of firm or overall concentration growth to mergers have been asking the question: What would the growth of large firms or increase in overall concentration have been had there been no mergers?[15]

The most systematic examination of this question is by John McGowan (1965). He found that:

> ... mergers appear to play a substantial role in allowing firms ... to grow faster than the aggregate growth rate. Furthermore, though there are exceptions, the tendency appears to be that as the firm increases its size its ability to grow faster than the aggregate depends increasingly upon growth by merger ... as the firm becomes relatively very large its ability just to maintain its position seems heavily dependent upon growth by merger. (p. 434)

McGowan concluded that mergers accounted for almost [illegible] of the increase in the 500 firm concentration ratio between 1950 and 1960, and almost [illegible] the increase in the 100 firm ratio (pp. 455–456).

The FTC study quoted above, also tried to answer the same question for the 1960s, although with less sophistication than McGowan, as did Lee Preston (1973). These studies confirm or even strengthen McGowan's conclusions as to the importance of mergers in explaining increases in overall concentration. The FTC's figures indicate an increase in the share the assets held by the largest 200 manufacturing corporations between 1960 and 1968 from 54.1% to 60.9% (1969, pp. 189–193). Over the same period the assets acquired by the largest 200 firms amounted to 10% of total manufacturing assets. Thus, if no mergers had taken place, and other forms of growth were not fully substituted for mergers, overall concentration might have actually fallen over this period. This is in fact what one would expect to have happened. In the absence of mergers overall concentration should rise during periods of contraction due to the greater vulnerability of smaller firms, and fall during upswings, due to new entry and the more rapid growth of smaller companies. This expectation was confirmed over the relatively merger free period of 1929–1947 when concentration rates increased substantially during the decline in business activity from 1929 to 1933, and then declined significantly during the economic recovery starting in 1933 and extending through World War II [Scherer (1971, pp. 41–45)]. Thus, one would expect overall concentration to have fallen over the sustained economic advance of the 1960s; that it did not is probably attributable to the merger wave.[16] Studies of the impact of mergers on concentration in the U.K. [Aaronovitch and Sawyer (1975); Hannah and Kay (1977)] and West Germany [Müller and Hochreiter (1976)] have reached similar conclusions.

---

[13] Some of the rise in the acquired company's stock price may have been brought about through the acquiring firm's 'buying in' before the formal announcement. But Gagnon, et al. show that not all of the increase in volume of transactions can be explained in this way, and thus probably not all of the change in price. Any change in the volume traded or price of the acquiring firm's stock obviously cannot be explained in this way.

[14] For surveys of the early literature on this point, see Markham (1955) and Reid (1968, chs. 3, 4, 5).

[15] For a similar interpretation of these differences see Preston (1971, 1973).

Those authors who appear to have reached a different conclusion have in fact been asking the following question: What has been the ratio of assets acquired by the largest firms to their total growth? These studies have generally found this ratio to vary from 10 to 25 percent depending on the time period and group of firms covered [Bock (1970); Backman (1970); Piccini (1970); Markham (1973, pp. 114–124); Steiner (1975, pp. 289–307)]. That these are different questions, and that the answers obtained are consistent with one another can be most easily seen from the following example. Suppose the economy consisted of 1000 firms of equal size, each growing at 3 percent per year. In the absence of any mergers, entry or exit, overall concentration would remain unchanged. The 100 largest would always control 10 percent of assets. Suppose, however, 100 firms begin acquiring 1 percent of the total assets outstanding each year by acquiring 10 of the other 900 firms per year. This amounts to one acquisition per acquiring firm every 10 years. After 90 years all of the other firms are gone; the 100 largest possess all of the economy's assets. The percentage growth in assets of the top 100 accounted for by mergers would fall from 77% in year one to 25% in year 90. Yet, there would have been no increase in concentration had there not been any mergers. Thus, a falling and eventually relatively small ratio of growth via merger to total growth is consistent with the conclusion that all of the increase in concentration is a result of past mergers. Indeed, a falling ratio of merger to 'internal' growth is inevitable unless the largest firms follow a strategy of acquiring an ever-increasing percentage of the nation's total assets.

Those studies such as Backman (1970), Bock (1970, and earlier, Weston (1953), which adjust overall concentration or firm growth rates by past ratios of acquired to total asset growth, build in the questionable assumption that the acquired firm stopped growing at the time of its acquisition and that all subsequent growth is internal. Thus, over time, the contribution of any given merger to a firm's growth or the change in overall concentration under this procedure tends to zero. The conclusion that mergers are an unimportant source of growth or overall concentration change, which these studies draw, is thus not particularly surprising.

For policy purposes, the relevant question is what the level of concentration would be without any mergers. The answer seems fairly clear—significantly lower.

5. Policy implications

The evidence reviewed in this paper indicates that mergers result in no net gains to the acquiring firm's stockholders. Those studies which have drawn conclusions to the contrary have based these conclusions on profit and stock price increases occurring in the period of economic and stock market buoyancy, or on returns earned on stocks prior to the merger, and not always directly (or causally) related to the merger. Even then most of the positive results found have not been statistically significant at conventional confidence intervals. These positive results on mergers seem fully offset by those which have concluded on the basis of post merger results, or data extended beyond the stock market peak, that mergers are breakeven or unprofitable ventures. The results from the relevant studies are summarized in table 3.

This evidence is broadly consistent with the hypothesis that managers pursue corporate growth or other objectives that are not directly related to stockholder welfare and economic efficiency. This hypothesis can explain why managers of acquiring firms undertake mergers providing no benefits for their stockholders; why managers of acquisition targets vigorously resist bids which would greatly enrich their stockholders.

Nevertheless, one might argue that this literature presents no compelling case for government intervention. For there is no evidence that mergers now result in significant anticompetitive effects, and the studies suggesting that mergers are on average failures, are partially offset by those concluding that they are breakeven ventures. If mergers do not make things any better, they also do not make them much worse. Assuming the latter inference is valid, why not let managers pursue whatever goals they choose?

One cost of the pursuit of growth via external expansions, which has been cited in the literature, is that it is likely to come at the expense of more socially productive forms of growth [Reid (1968); Sichel (1970)]. Mergers compete directly with capital investment, R&D and other investment-type expenditures for cash flows and managerial decisionmaking capacities. While a manager is perhaps indifferent between whether a given rate of expansion is achieved through internal or external growth, society is likely to be better off through the creation of additional assets. Two of the studies discussed here present direct

---

[16] This is also consistent with McGowan's conclusion that overall concentration would eventually decline if all mergers were prohibited (1965). See also Preston (1973). There are various upward and downward biases in using the percentage of assets acquired as an indication of the importance of mergers, of course, but the figures give one a rough idea. See the FTC's discussion of these biases (1969) as well as Bock's (1970).

Table 3

Summary of recent studies of returns from mergers for acquiring firms' stockholders.[a]

Author	Sample	Control group	Time period	Returns acquiring firms	Returns control group	Significance test
Hogarty (1970b)	43 nonconglomerates engaged in heavy merger activity activity	Firms in acquiring company's base industry	1953–64	−0.01 (one percent below returns of industry)		$\sigma = 0.11$ (difference from zero insignificant)
Lev and Mandelker (1972)	69 firms making large acquisitions (conglomerate and otherwise)	69 nonmerging firms matched by industry and size	1952–63	0.056 (05.6 percent above return of stock of matched sample)	--	$Z = 1.40$
Weston, Smith and Shrieves (1972)	48 conglomerates	50 mutual funds	1960–69	Ave. returns 1.262 Sharpe 0.364 Treynor 0.131 α/β 0.097	1.091 0.313 0.054 0.020	$F = 22.83^{**}$ 1.75 6.21^{*} 6.21^{*}
Melicher and Rush (1973)	45 conglomerates	45 nonconglomerates base industry as of 1960	6/66–12/71	Ave. returns 1.008 Sharpe 0.045 Treynor 0.004 Jensen α 0.002	1.007 0.047 0.005 0.001	$F = 0.20$ 0.03 0.80 0.18
Halpern (1973)	78 mergers by nonconglomerate firms	market portfolio	1/50–7/65	0.063 (mean cumulative residual of larger firm up to date of merger)		$\sigma = 0.31$ (difference from zero insignificant)
Mandelker (1974)	241 large acquisitions (conglomerate and nonconglomerate)	market portfolio	1941–63	0.0005 (cumulative residual in 7 mos. preceding merger using premerger β).		$t = 0.04$
				0.0023 (cumulative residual in 20 mos. preceding merger using postmerger β)		$t = 1.73$
				0.0003 (cumulative residual in 20 mos. after the merger using postmerger β)		$t = 0.033$
Haugen and Langetieg (1975)	59 large nonconglomerate mergers	59 matched pairs of firms	1951–1968	1 > *market index 3 < *market index	1 > *market index 3 < *market index	No significant difference exists in the proportions of success and failures in the two groups
Mason and Goudzwaard	22 conglomerates	22 matched portfolios	1962–1967	0.07[illegible]	0.1275 SM portfolio 0.1182 Mutual fund 0.1399 Buy and hold	$Z = 1.93^{*}$ $Z = 1.59$ $Z = 2.33^{*}$

[a] Notes: *indicates significant at the 0.05 level, **indicates significant at the 0.01 level.

evidence that mergers do come at the expense of internal growth. Hogarty (1970a) found that the post merger sales of the merging firms were lower than predicted from their premerger sales.[17] Lev and Mandelker found that the *internal* growth rates of acquiring firms decreased in the post-merger period, a result they attributed to 'perhaps a "shakedown" or "digestion" effect' (1972, p. 97).

A second cost of mergers is the rise in overall concentration they bring about, as documented in the preceding section, and the reduction in the number of independent economic entities this entails [on the latter see Preston (1971, p. 21)]. The usual argument by economists is that increases in industry concentration constitute a potential economic (market power) problem, increases in overall concentration, if anything, a political (power) problem. Up until the 1970s the latter would then be quickly dismissed as unsubstantiated or beyond the bounds of economic analysis. But, I trust, the age of innocence regarding corporate power is now over. Large corporations both have and utilize political power. And it seems reasonable to assume that this power is positively related to company size.[18] A policy curtailing mergers and reversing upward trends in overall concentration would be a first step toward halting, if not reversing, increases in corporate power.

Space precludes a review of all the proposals to constrain merger activity that have been put forward [see Steiner (1975, ch. 12)]. The main issues can be illustrated, however, by focussing on the two polar extremes: maintenance of the present policy, or a flat ban on all mergers.

The *economic* rationale underlying the antitrust laws is based on a variant of the invisible hand argument as applied to price competition. If managers maximize profits then the allocation of resources is most efficiently achieved through the independently set prices of each firm. Government intervention is warranted only to prevent collusion and other efforts to monopolize. But the invisible hand analogy breaks down when one switches to investment-type activities, and allows for nonprofit maximization objectives. Just as there is no proof that competition for sales among firms via advertising results in improved allocational efficiency, there is no proof or evidence that the pursuit of growth via merger leads to anything more than external growth at the expense of internal growth.

Acceptance of this argument would suggest abandoning the invisible hand premise as an underpinning for some parts of antitrust legislation. With respect to mergers this could imply a ban on all mergers, perhaps limited to companies above a given size, and subject to an 'efficiencies defense.' The latter could be

written fairly broadly to include explicitly replacement of bad managers (as well as rescue of failing firms), capital transfer efficiencies, and perhaps other efficiency gains put forward in the literature. The major difference between this law and the present one would be in locating the burden of proof. Instead of the government having to prove a substantial lessening of competition, the companies would have to prove likely efficiency gains.

Obviously if anything like the present number of mergers were to take place, such a law could be a tremendous administrative burden. The assumption is, based on the surveyed evidence regarding the number of successful mergers occurring, that only a small fraction of the mergers presently undertaken would promise sufficient efficiency gains to be capable of defending on these grounds in court.

It can be argued that such a law would reduce the threat of takeover and thereby increase the scope of managerial discretion and potentially lead to an even more inefficient allocation of resources than under the present law. Smiley (1976) explains the decline in share prices he observes before takeover as evidence of the exercise of managerial discretion, and other studies finding lower returns or profits before merger are consistent with this view. But as noted above, the evidence on this point is in conflict. In addition, Smiley's own results, and the data on returns to acquiring firms, suggests that the gains from replacing incompetent or nonstockholder welfare maximizing managers have not been all that large. Nevertheless, any effort to curtail the volume of merger activity should, to be consistent, be accompanied by other measures to improve the markets for capital and corporate control. More detailed accounting procedures, less costly procedures for engaging in proxy fights or direct takeovers, and perhaps even measures forcing a greater payout of profits and more reliance on the external capital market.

Some of the evidence surveyed here concerning the greater profitability of the target firms in conglomerate mergers is consistent with the capital redeployment thesis, and also suggests a possible worsening of efficiency from an effective curtailment of merger activity. Here the possibility of internal expansion and diversification should be kept in mind, as well as an 'efficiencies defense' for mergers. The usual argument for mergers over internal expansion is that they allow the firm to achieve the potential efficiency gain faster than if it must expand internally [Williamson (1968)]. But, the evidence cited here on profit and return on equity effects indicates that no efficiency gains are realized *or perceived* by the market in the first few years following the merger. Perhaps, this too is a result of the digestion problems Lev and Mandelker suspect are inhibiting post merger growth. But, whatever the cause, these results imply a small loss, if any, to society from waiting for the benefits from a redeployment of capital to follow internal diversification.[19]

---

[17] Because of this Hogarty rejects growth in sales as the motive for mergers (1970a, p. 389). His conclusion ignores the immediate growth of the acquiring company brought about by the merger. If this is the growth sought, Hogarty's results are not inconsistent with this objective.

[18] For a pioneering and largely successful effort to relate political power to industry concentration see Pittman (1976).

[19] Internal expansion is not a viable alternative under Cable's 'information search' variant on the redeployment of capital thesis (1976).

Several writers have pointed out that growth through merger is not the only form of growth, and the conglomerates in particular are not the only or even necessarily the worst abusers of political power. [Steiner (1975, chs. 11, 12); Williamson (1975, pp. 170–171)]. Their points are well taken. The reasons for singling out growth through merger, conglomerate or otherwise, for discriminatory treatment is that it is the easiest form of growth to attack, it is a main contributor to increasing overall concentration, and we have good evidence that there will be negligible efficiency losses from such a policy. This policy need not be considered a substitute for or superior to a broad scale attack on existing market power. It is simply a place to start.

6. Conclusion

It has become customary to close a review of the merger literature by observing that the arguments are still in conflict, the main issues still in doubt, and from this draw the prudent conclusion that policy changes should proceed slowly and cautiously. True, the a priori theories of mergers' causes and effects are still in conflict, and will probably always remain so. But the empirical literature, upon which this survey focusses, draws a surprisingly consistent picture. Whatever the stated or unstated goals of managers are, the mergers they have consummated have on average not generated extra profits for the acquiring firms, have not resulted in increased economic efficiency. Admittedly some unsolved riddles remain, but all discussion of serious policy alternatives need not be set aside until these are resolved.

Although a recommendation to proceed cautiously in the face of conflicting evidence seems on the surface reasonable enough, it is in fact a recommendation to accept the neoclassical theories of mergers, stick with the status quo policy on mergers, and accept this policy's underlying premise of an invisible hand guiding the market for control.

We now have almost a century of accumulated evidence as to the effects of a laissez faire policy toward mergers. Enough time has elapsed and evidence been gathered that one can say that this policy experiment has not been a success. The time has come to try a new experiment. I think we can now legitimately ask managers to prove prior to a merger, that this merger is likely 'to substantially lessen' inefficiency.

References

Aaronovitch, S. and M.C. Sawyer, 1975, Mergers, growth and concentration, Oxford Economic Papers 27, 136–155, March.

Bachman, J., 1970, Conglomerate mergers and competition, St. John's Law Review, special edition 44, 90–132, Spring.

Beckenstein, A.R., 1977, Merger activity and merger theories: An empirical investigation, mimeo, University of Virginia.

Binder, D., 1973, An empirical study of contested tender offers: 1960–1969, S.J.D. thesis, Law School, University of Michigan.

Bock, B., 1970, Statistical games and the '200 largest industrials,' 1954 and 1968, New York: National Industrial Conference Board, 1970.

Boyle, S.E., 1970, Pre-merger growth and profit characteristics of large conglomerate mergers in the United States 1948–68, St. John's Law Review, special edition 44, 152–70, Spring.

Brenner, M. and D.H. Downes, 1975, A critical evaluation of the measurement of conglomerate performance, using the capital asset pricing model, Berkeley, Research Program in Finance, Working Paper No. 35, May.

Cable, J., 1976, Searching by merger and the transfer of capital, IIM, Berlin.

Conn, R.L., 1973, Performance of conglomerate firms: Comment, Journal of Finance 28, 154–159, June.

Conn, R.L., 1976, The failing firm/industry doctrines in conglomerate mergers, Journal of Industrial Economics 24, 181–187, March.

Dewey, D., 1961, Mergers and cartels: Some reservations about policy, American Economic Review 51, 255–262, May.

Ellert, J.C., 1976, Mergers, antitrust law enforcement and stockholder returns, Journal of Finance 31, 715–732, May.

Evans, J.L. and S.H. Archer, 1968, Diversification and the reduction of dispersion: An empirical analysis, Journal of Finance 23, 29–40, December.

Federal Trade Commission, 1969, Economic report on corporate mergers, Washington, D.C.: United States Government Printing Office.

Federal Trade Commission, 1972, Economic report on conglomerate merger performance, an empirical analysis of nine corporations, Washington, D.C.: United States Government Printing Office, November.

Firth, M., 1976, Share prices and mergers, Westmead, England: Saxon House.

Gagnon, J.-M., P. Brehain and F. Gouzra, 1976, Stock market behavior of merging firms: The Belgian experience: I, Mons, Belgium.

Goldberg, L.G., 1973, The effect of conglomerate mergers on competition, Journal of Law and Economics 16, 137–158, April.

Goldberg, L.G., 1974, Conglomerate mergers and concentration ratios, Review of Economics and Statistics 56, 303–309, August.

Gort, M., 1966, Diversification, mergers and profits, in: W. Alberts and J. Segall, eds., The corporate merger, Chicago: University of Chicago Press.

Gort, M., 1969, An economic disturbance theory of mergers, Quarterly Journal of Economics 83, 624–642, November.

Gort, M. and T.F. Hogarty, 1970, New evidence on mergers, Journal of Law and Economics 13, 167–184, April.

Grabowski, H.G. and D.C. Mueller, 1975, Life-cycle effects on corporate returns on retentions, Review of Economics and Statistics 57, 400–409, November.

Halpern, P.J., 1973, Empirical estimates of the amount and distribution of gains to companies in mergers, Journal of Business 46, 554–75, October.

Hannah, L. and J.A. Kay, 1977, Concentration in modern industry (Macmillan, London).

Haugen, R.A. and T.C. Langetieg, 1975, An empirical test for synergism in merger, Journal of Finance 30, 1003–1014, September.

Haugen, R.A. and J.G. Udell, 1972, Rates of return to stockholders of acquired companies, Journal of Financial and Quantitative Analysis 7, 1387–1398, January.

Hayes, S.L. III and R.A. Taussig, 1967, Tactics of cash takeover bids, Harvard Business Review 45, 135–148, March–April.

Hogarty, T.F., 1970a, Profits from Mergers: The evidence of fifty years, St. John's Law Review, special edition 44, 378–391, Spring.

Hogarty, T.F., 1970b, The profitability of corporate mergers, Journal of Business 43, 317–327, July.

Holzmann, O.J., R.M. Copeland and J. Hayya, 1975, Income measures of conglomerate performance, Quarterly Review of Economics and Business 15, 67–78, Autumn.

Joehnk, M.D. and J.F. Nielsen, 1974, The effects of conglomerate merger activity on systematic risk, Journal of Financial and Quantitative Analysis 9, 215–225, March.

Kuehn, D., 1975, Takeovers and the theory of the firm (Macmillan, London).

Lev, B. and G. Mandelker, 1972, The microeconomic consequences of corporate mergers, Journal of Business 45, 85–104, January.
Levy, H. and M. Sarnat, 1970, Diversification, portfolio analysis and the uneasy case for conglomerate mergers, Journal of Finance 25, 795–802, September.
Lewellen, W., 1971, A pure financial rationale for the conglomerate merger, Journal of Finance 26, 521–537, May.
Lintner, J., 1971, Expectations, mergers and equilibrium in purely competitive securities markets, American Economic Review 61, 101–111, May.
Lorie, J.H. and P. Halpern, 1970, Conglomerates: The rhetoric and the evidence, Journal of Law and Economics 13, 149–166, April.
Lynch, H.H., 1971, Financial performance of conglomerates (Harvard Business School, Boston).
Mandelker, G., 1974, Risk and return: The case of merging firms, Journal of Financial Economics 1, 303–335, December.
Manne, H., 1965, Mergers and the market for corporate control, Journal of Political Economy 73, 110–120, April.
Manne, H., 1966, Insider trading and the stock market (Free Press, New York).
Markham, J., 1955, Survey of the evidence and findings on mergers, Business concentration and public policy (National Bureau of Economic Research, New York).
Markham, J., 1973, Conglomerate enterprise and public policy (Harvard Business School, Boston, Mass.).
Marris, R., 1964, The economic theory of managerial capitalism (Free Press, Glencoe, Ill.).
Mason, R.H. and M.B. Goudzwaard, 1976, Performance of conglomerate firms: A portfolio approach, Journal of Finance 31, 39–48, March.
Mead, W.J., 1969, Instantaneous merger profit as conglomerate merger motive, Western Economic Journal 7, 295–306, December.
Melicher, R.W. and D.F. Rush, 1973, The performance of conglomerate firms: Recent risk and return experience, Journal of Finance 28, 381–388, May.
Melicher, R.W. and D.F. Rush, 1974, Evidence on the acquisition-related performance of conglomerate firms, Journal of Finance 29, 141–149, March.
Mingo, J.J., 1976, Managerial motives, market structures and the performance of holding company banks, Economic Inquiry 14, 411–424, September.
McGowan, J.J., 1965, The effect of alternative antimerger policies on the size distribution of firms, Yale Economic Essays 5, 423–474, Fall.
McGowan, J.J., 1971, International comparisons of merger activity, Journal of Law and Economics 14, 233–250, April.
Mueller, D.C., 1969, A theory of conglomerate mergers, Quarterly Journal of Economics 83, 643–659, November.
Mueller, D.C., 1972, A life cycle theory of the firm, Journal of Industrial Economics 20, 199–219, July.
Müller, J. and R. Hochreiter, 1975, Stand, entwicklung und konsequenzen der unternehmenskonzentration in der Bundesrepublik, IIM, Berlin.
Nelson, R., 1959, Merger movements in American industry 1895–1956 (Princeton University Press, Princeton).
Nelson, R.L., 1966, Business cyle factors in the choice between internal and external growth, in: W. Alberts and J. Segall, eds., The corporate merger (University of Chicago Press, Chicago).
Nielsen, J.F. and R.W. Melicher, 1973, A financial analysis of acquisition and merger premiums, Journal of Financial and Quantitative Analysis 8, 139–148, March.
Piccini, R., 1970, Mergers, diversification, and the growth of large firms: 1948–1965, St. John's Law Review, special edition 44, 171–192, Spring.
Piper, T.F. and S.J. Weiss, 1974, The profitability of multibank holding company acquisitions, Journal of Finance 29, 163–174, March.
Pittman, R., 1976, The effects of industry concentration and regulation on contributions in three 1972 U.S. Senate campaigns, Public Choice 27, 71–80, Fall.
Preston, L.E., 1971, The industry and enterprise structure of the U.S. economy (General Learning Press, New York).
Preston, L.E., 1973, Giant firms, large mergers and concentration: Patterns and policy alternatives, 1954–1968, Industrial Organization Review 1, 35–46.
Reid, S.R., 1968, Mergers, managers and the economy (McGraw-Hill, New York).

Reid, S.R., 1971, A reply to the Weston/Mansinghka criticisms dealing with conglomerate mergers, Journal of Finance 26, 937–946, September.
Scherer, F.M., 1971, Industrial market structure and economic performance (Rand McNally, Chicago).
Sherman, R., 1972, How tax policy induces conglomerate mergers, National Tax Journal 25, 521–529, December.
Sichel, W., 1970, Conglomerateness: Size and monopoly control, St. John's Law Review, special edition 44, 354–377, Spring.
Singh, A., 1971, Takeovers: Their relevance to the stock market and the theory of the firm (Cambridge University Press, Cambridge).
Smiley, R., 1976, Tender offers, transactions costs and the firm, Review of Economics and Statistics 58, 22–32, February.
Steiner, P.O., Mergers (University of Michigan Press, Ann Arbor, Michigan).
Stevens, D.L., 1973, Financial characteristics of merged firms: A multivariate analysis, Journal of Financial and Quantitative Analysis 8, 149–158, March.
Stigler, G.J., 1950, Monopoly and oligopoly by merger, American Economic Review 40, 23–34, May.
Thorp, W.L., 1931, The persistence of the merger movement, American Economic Review 21, 77–89, March.
Weston, J.F., 1953, The role of mergers in the growth of large firms (University of California Press, Berkeley).
Weston, J.F., 1970, The nature and significance of conglomerate firms, St. John's Law Review, special edition 44, 66–80, Spring.
Weston, J.F. and S.K. Mansinghka, 1971, Tests of the efficiency performance in conglomerate firms, Journal of Finance 26, 919–936, September.
Weston, J.F., K.V. Smith and R.E. Shrieves, 1972, Conglomerate performance using the capital asset pricing model, Review of Economics and Statistics 54, 357–363, November.
Williamson, O.E., 1968, Economies as an antitrust defense: The welfare tradeoffs, American Economic Review 58, 18–36, March.
Williamson, O.E., 1970, Corporate control and business behavior: An inquiry into the effects of organization form on enterprise behavior (Prentice-Hall, New York).
Williamson, O.E., 1975, Markets and hierarchies: Analysis and antitrust implications (Free Press, New York).

EXHIBIT 2.—"THE CASE AGAINST THE CONGLOMERATE MERGERS"

The Case Against Conglomerate Mergers

Dennis C. Mueller

The case against conglomerate mergers is that there is no strong case for them. Many mergers do not appear to be consummated with the intent to achieve efficiency gains. True, there are many hypotheses regarding the kinds of efficiencies mergers might achieve. But, these hypotheses are for the most part either subject to logical counterarguments, or second best strategies for improving aggregate economic efficiency, or inconsistent with the available empirical evidence. Moreover, whatever the motivation behind mergers, their effects are not to improve economic efficiency. It is impossible to prove from the available empirical evidence that the performance of either the individual merging firms or the economy at large is significantly better as a result of all of the mergers that have occurred in this country.

In this paper I first present a theory of why mergers occur without promise of market power or efficiency increases, and indicate the advantages of this theory over some of its more popular alternatives. Next I examine some empirical evidence regarding the efficiency effects of mergers. Finally, I comment on how all of this amounts to a "case against conglomerate mergers."

I. Mergers and the Life Cycle of Firms

Most firms come into existence to exploit some innovative idea, to fill some market interstice. If the innovation is a good one, the company thrives and grows until the gap in the market has been filled. As this product market matures, new markets will have to be entered to sustain growth. As Schumpeter [1934] depicted it, the corporation can grow (survive) indefinetly only by continually innovating. The successful, mature corporation is one, whose managers can "manage" innovation, and thereby sustain a continual flow of new products and processes [Schumpeter, 1950].

Alternatively, the mature corporation may choose to acquire its "new" products and processes from outside, i.e., to engage in mergers. When additional products are acquired through the purchase of established firms, however, assets are acquired whose value is already established in the markets for corporate debt and equity. If these markets are efficient, these prices should fully anticipate all future profit streams. If the acquiring firm's profits are not to suffer it must do something with the acquired firm's assets that improve its profitability, e.g., enhance its market power or internal efficiency.

I shall not review all of the hypotheses concerning mergers and efficiency or market power, since this has been done elsewhere.[1] One hypothesis, which is quite close to the life-cycle theory, must be mentioned, however. Several writers, most notably J. Fred Weston [1970], and Oliver Williamson [1970, 1975] have argued that mergers may be the most efficient way to redeploy capital from mature corporations with low internal investment opportunities to young(er) companies with high(er) internal rates of return. Since the higher expected returns of the younger firm are already reflected in its market price, this argument still relies on some extra profits being generated after the merger. One possibility is that the mature firm's management team is highly efficient, and that a loss would be suffered if it had to be disbanded.

But managers have incentives to preserve their team, maintain and expand their organization, even when its internal efficiency is not superior, and perhaps even inferior to other organizations (see Marris [1964, ch. 2]).

Managers can be expected to resist a slow growth, gradual decline trajectory for their company even when following this path would be in the best interests of their stockholders and society. Thus, evidence that mature firms engage most frequently in mergers is consistent with both a managerial, life-cycle view, and a neoclassical, redeployment of capital hypothesis.[2] To distinguish between the two, additional predictions and observations are needed.

The managerial-growth hypothesis is one of a family sharing the following assumptions: (1) managers have discretion to pursue goals in conflict with their stockholders, (2) this pursuit is constrained by the threat of takeover should the firm's share price fall too far, and (3) the means to pursue these goals are the company's internal cash flows. The various theories differ according to the assumed use to which these funds are put, e.g. expansion of sales, staff and emoluments, security. The life-cycle, growth hypothesis assumes that these funds are invested to achieve growth (avoid decline) even when some of the funds could have been more profitably redeployed by stockholders elsewhere. The acquisition of companies at prices substantially above their current market value is an obvious potential form of this growth-oriented investment.

Several additional points must be made. First, the theory assumes managerial discretion not the separation of ownership and control. Widespread stock ownership does in general provide managers freedom from owner control to pursue managerial goals. But the converse does not necessarily follow. Concentration of share ownership need not result in the maximization of stockholder welfare. If a large fraction of shares is held by management, its discretionary power is increased, for the probability of a successful takeover is reduced. While the managers' pecuniary interests are more closely tied to the stockholders' interests in this situation, the costs of an extra dollar of on-the-job consumption are still shared, and the benefits accrue entirely to management. If managers with large shareholdings favor their goals qua-managers to their interests as stockholders, their companies may exhibit the most extreme form of managerial behavior of all.[3] Thus, one cannot simply dismiss the hypothesis that the managers of acquisition-oriented conglomerates with poor performance records were pursuing growth at the expense of share price, simply by pointing to the large shareholdings of their managers, as some are wont to do.[4]

In the absence of full information on the part of stockholders, any exogenous event that raises a company's share price should reduce the threat of takeover and increase management's discretion to pursue its own goals. A general rise in stock prices may make managers more willing to undertake mergers, because the rise in prices may offset any negative impact a merger's announcement has on the acquiring company's shares, and/or because in the bullish environment of a stock market upswing news of the merger might be treated more favorably than in a normal or bear market situation. Thus, the danger to the acquiring firm of an adverse price reaction in the announcement of a merger resulting in a significant increase in the threat of takeover is likely to be smaller in a rising stock market.

Several studies have observed an increase in the returns earned on acquiring company shares prior to a merger.[5] While these unexplained increases in returns are too far in advance of the mergers to the explained by the mergers, it is possible that the increases explain the mergers. An unanticipated improvement in the performance of a company's common shares should reduce the threat of takeover and free a management to engage in acquisitions it otherwise would not have. Note that there is no reason under the neoclassical theory why an improvement in the acquiring firm's position should precipitate a merger. An acquiring company's shareholders will benefit from a merger only if the performance of the acquiring company or the acquired company is improved _through the merger_. Thus, any neoclassical explanation for mergers must depend on the characteristics of the acquired company or the combination of the two firms. Changes in the acquiring firm's position alone, or the market's view of its position cannot make an otherwise unprofitable merger profitable.

The important role cash flow plays in the managerial theory is widely underappreciated, and is a possible source of empirical validation of the two theories. As Dale Jorgenson has repeatedly emphasized, a cash flow model of investment is inconsistent with the neoclassical theory.[6] The neoclassical cost of capital is the rate of return the shareholders can earn on investments (e.g., stocks of other firms) of comparable risk [Miller and Modigliani, 1958]. The cost of using internal fund flows to finance investment is the same as for new debt or equity. Internal fund flows are not relatively "cheap" in the seventies any more than new debt or equity was relatively "cheap" in the sixties. Thus, the level of merger activity in the seventies, and the heavy reliance on internal cash flows to finance acquisitions, at least relative to the sixties, cannot be easily explained as some shift in the neoclassical cost of capital.

Nor can one sustain the argument that mergers are taking place today, because the assets of many firms are undervalued. The capital asset pricing literature teaches us that the capital market is efficient in using the available information about a firm's prospects to price its securities.[7] If market values are low today relative to book values, that is because the market does not expect firms to do well in the future, a prediction not without some justification. Assets are not undervalued today, any more than they were overvalued in the sixties when market values were way above book values.[8] Managers can increase the value of their company's shares through an acquisition only if they know something the market (and the other firm's managers and their own stockholders) does not, or can do something with these assets the incumbent managers cannot. But these explanations for mergers are valid at all points in time. Superior talent or omniscience on the part of acquiring firms' managers can always justify a merger.

A related argument one sometimes hears is that mergers are occurring today, because it is cheaper to buy a given bundle of assets as an ongoing firm, than as new capital equipment. As a statement about relative prices of capital this may be true, but as an explanation of mergers it begs the question. If a company is selling for less than the replacement value of its assets, then the market does not think that the purchase of these assets at book value would provide a normal return on investment. The company's managers paid too much for them. Why, given this evaluation by the market, is the acquiring firm's management committed to acquiring assets in this industry? Do they know something the market does not know, or are they perhaps pursuing another goal?

In contrast to the neoclassical theory, the managerial-growth hypothesis is quite compatible with the evidence of the seventies. A growth-oriented management with excess cash will purchase additional assets, even at expected returns below its stockholders' opportunity costs, where a neoclassical management will not. Evidence supporting a cash flow theory of investment is evidence consistent with the managerial theory of the firm.[9]

The expected returns on internal investment in new capital, R & D, and advertising appear to have fallen over the seventies. The most vivid evidence of this is the value the market places on existing tangible and intangible capital stocks. Cash flows have not fallen so dramatically, however. Thus, cash flows are large relative to internal investment opportunities. Under neoclassical theory this should lead to greater dividends, or stock repurchases if taxes are to be minimized.[10] But neither of these contributes to growth. The return to be earned on acquiring another firm has not fallen relatively, however. It is what it always is — the normal return being earned in the market less the cost of transacting a merger. Thus, mergers have increased in attractiveness relative to internal investment, and those managerial firms that are fortunate enough to have ample cash flows will use them to acquire other companies.

Let me close this section with a prediction that follows directly. Petroleum firms now dominate the 10, 50 and 100 largest lists. Known reserves and likely new finds will not allow these companies to maintain these relative size positions. Petroleum companies must diversify or decline. Currently, however, they are blessed with substantial cash flows. Thus, we have companies in the very mature stages of their product life cycle, with large internal fund flows. The managerial theory predicts heavy merger acitivity by these companies. I do not see, however, why the combination of mature product cycle and large cash flows should make petroleum managers particularly expert at spotting "undervalued" firms or *managing* companies outside of the petroleum area. Thus, I would not expect to see heavy merger activity in this industry on the basis of neoclassical motives.

II. The Efficiency Effects of Mergers

There are so many hypothesized causes of mergers that some must succeed to explain some mergers. Moreover, the life-cycle, managerial theory has many features in common with some of the neoclassical theories. Thus, an evaluation of competing theories cannot be made from arguments and evidence regarding determinants alone. We must examine their effects. If mergers improved efficiency substantially, then all theories making this prediction receive support, and the case against mergers is weakened. If mergers have not led to efficiency increases, then the managerial theory is supported, and so too the case against mergers.

A. Evidence from Outside of the U.S.

I would like to begin by briefly summarizing results from an international comparison of mergers soon to be published [Mueller, 1980]. These results are of interest, both because they come from an additional, unexplored data source, and because they deal predominently with horizontal mergers. Since the neoclassical hypotheses presume a market power or efficiency increasing objective, and these are easiest to accomplish by horizontal acquisition, the results from other countries should confirm the neoclassical theory if any do. Indeed, we were so certain that these predominantly horizontal mergers would produce profit increases, that we intended to focus on their effects on sales. If a merger increases market power, price would rise, and if the firm was maximizing profit it would be in elastic portion of its demand schedule, so sales would fall. If efficiency increased, price should fall, and sales rise. Thus, we thought, at the outset, that the interesting part of our study would be the differentiation of profitable, horizontal mergers into market power or efficiency increasing.

But the mergers did not prove to be profitable on average. Table 1 summarizes the effects of mergers on profits for the seven countries in our study.[12] For each pair of merging companies we computed the combined profit rate for the two companies over the 5 years preceeding the merger. This was subtracted from the profit rate for the merged companies for the 3 to 5 years (depending on data availability) after the merger. This difference was the change in profit rate attributed to the merger. To adjust for cyclical and other time - dependent factors an analogous statistic was computed for a pair of nonmerging companies matched by size and industry (MAGMAD) to the two merging companies over the same time period. The statistics in Table 1 are the differences in sample means for these two samples, and the t statistic from a comparison of their means. Thus, the entry for France for the profit/equity ratio of -.018 indicates that the change in profit/equity ratio for a pair of merging firms was on average 1.8 percentage points below that of a size and industry matched nonmerging pair of firms over the same time interval. The t value of -0.79 indicates that the differences in sample means is not statistically significant. For Belgium the levels of statistical significance are reported rather than t values. In addition, the actual changes in profit rates of the merging firms were compared to changes in their profits projected (PROJECTED) on the basis of the changes in average profit rates of their base industries.

TABLE 1

COMPARISON OF PROFIT RATE CHANGES FOLLOWING MERGERS FOR MERGING AND NONMERGING FIRMS

		Profit/Assets		Profit/Equity		Profit/Sales	
COUNTRY		Difference	t	Difference	t	Difference	t
Belgium	MAGMAD	.012	.02*	.015	0.11*		
	PROJECTED	.003	0.81*	.011	0.39*		
France	MAGMAD	-.002	-0.41	-.018	-0.79	-.006	-0.82
	PROJECTED			-.028	-1.28	-.016	-1.27
Holland	MAGMAD		-3.30		-3.42		-0.85
	PROJECTED		-2.59		-3.24		-0.91
Sweden	MAGMAD	-.008	-0.77	-.010	-1.24	-.002	-0.70
	PROJECTED			-.007	-0.28	-.001	-0.15
West Germany	MAGMAD	.003	0.18	.035	0.35	.027	0.79
	PROJECTED	.007	0.65	.066	0.68	.004	0.55
United Kingdom	MAGMAD	.009	2.36	.009	2.86	.006	1.88
United States	MAGMAD	-.038	-0.92	-.084	-0.83	-.029	-0.89
	PROJECTED	-.045	-1.15	-.065	-2.37	-.038	-1.17

*Level of significance based on _t_-test.

MAGMAD. Difference from sample mean for a weighted average of size and industry matched nonmerging firms.

PROJECTED. Difference from mean of sample of projected values based on merging companies' industry trends.

If we confine our attention to the 6 European countries, we find that for 3 (France, Holland, and Sweden) the entries are all negative, and for the other 3 (Belgium, W. Germany and the United Kingdom) they are all positive. Thus, there is an even split between profit declines following mergers and profit increases. The same holds true if we confine our attention to statistically significant differences. For the UK all 3 comparisons of means were statistically significant, but the merging firms exhibited an improvement of less than 1 percentage point in each of the 3 profit rate measures compared to the nonmerging control group. Here one must note the differencies in sample sizes across countries. In the UK and US we had over 200 observations, enough to make most differences significant if there was any systematic tendency at all. In France and West Germany we had closer to 50 or 60 observations, in the smaller countries only 25 or 30.

It is difficult to see where mergers have had much of an impact positive or negative on profits in the six European countries. Given the dominance of horizontal mergers in the sample, the 14 authors of these studies were surprised by these results. They made the tests separating mergers into market power increasing and efficiency increasing somewhat anticlimatic. Nevertheless these results are surprisingly consistent and quite revealing. In none of the seven countries did the sales of the merging companies expand faster than they did for the control groups to imply an improvement in efficiency. In Holland and the US there was a significant relative decline in the sales of the merging firms. In the other 5 countries there was no statistical difference in sample means.

Since we had but 3 to 5 years after the mergers to test for their effects, it is possible that not enough time was allowed for improvements in profitability to be observed. Therefore, we tested for the impact of the mergers on the returns of the shares of the acquiring companies. If the mergers promise future profit increases these should be reflected in the prices of the acquiring company's shares, and yield increases in the returns on these shares. We again used before and after matched-sample comparisons. The time period after the merger was defined variously as (1) the year of the merger, r_t, (2) the year of the merger and the following year, r_{t+1}, (3) the 3 year period including the year of the merger and the following two years r_{t+2}, (4) the year of the merger and the following 3 years, r_{t+3}. Thus, we allowed for a range of possible time periods over which the market could evaluate the consequences of the merger.

Column 1 of Table 2 (column 2 for Holland) indicates that the market's initial reaction to the mergers was generally favorable. Eight of the ten comparisons are positive, six are positive and statistically significant. As more time elapses, however, the picture changes. In France, Holland, the United Kingdom and the United States (for the size and industry matched control group firms, MAG), there is a clear deterioration in the performance of the acquiring companies' common shares relative to either the size-industry-matched nonmerging control groups, or the returns for the acquiring firms projected from industry changes. In Belgium and Sweden the relative deterioration in performance is not as steady or significant, but the indication that the shareholders of acquiring firms were better off, which appears in the year of the merger, has disappeared come 3 years after the merger.

Thus, if one allows the market a full 3 years to evaluate the consequences of the mergers, none of the comparisons with the different control groups indicate that the stockholders of the acquiring companies are better off. In

TABLE 2

COMPARISONS OF RATES OF RETURN ON COMMON SHARES FOLLOWING MERGERS FOR MERGING AND NONMERGING FIRMS

	r_t		r_{t+1}		r_{t+2}		r_{t+3}	
COUNTRY	Difference	t	Difference	t	Difference	t	Difference	t
MAG	0.047	.08*	-.032	.32*	-.034	-0.31*	-.055	-0.16*
Belgium								
PROJECTED	0.083	0.04*	.068	.27*	.067	0.14*		
MAG	.116	3.69	.086	1.99	.058	1.29	.021	0.27
France								
MAG				2.03		1.79		0.92
Holland								
PROJECTED				0.14		0.68		-0.17
MAG	- .040	-0.34	.014	0.17	-.044	-0.70	-.029	-0.57
Sweden								
PROJECTED	.083	1.08	.025	0.44	-.040	-0.73	-.022	-0.27
MAG	.119	1.99	-.002	-0.05	-.056	-2.00	-.060	-1.78
United Kingdom								
MAG	.088	2.61	.039	1.43	.017	0.69	.004	0.19
United States								
PROJECTED	- .048	-2.22	-.048	-2.57	-.046	-2.56	-.040	-2.43

*Level of significance based on *t*-test.

MAG. Difference from sample mean for average of a control group sample of nonacquiring firms matched by size and industry to acquiring firm.

PROJECTED. Difference from mean of sample values based on projections of rate of return performance of average company in acquiring firms' base industry.

the UK and the US they would appear to be significantly worse off. The last result is somewhat intriging, since the UK and US have the most sophisticated stock markets. In all 6 countries the performance of the acquiring companies was worse three years after the merger than it was at the time of the merger. In 4 of the 6 countries the data suggested a continual relative decline in the market's evaluation of the mergers as time elapsed.

To our knowledge, our study is the only one to have examined the effects of mergers on profits and returns on common shares for the continental countries and Sweden. Other work has been done on the UK, however. Geoffrey Meeks [1977] examined the impact of mergers on the merging companies' assets for a sample of more than one thousand mergers. He concluded that the mergers had if anything worsened the operating performance of the merging companies. Meeks' findings with respect to operating performance are thus more negative than those of Cosh, Hughes and Singh in our study. Michael Firth [1979] studied the impact of the announcement of mergers on share prices. He found that shareholders of the acquired companies were significantly better off, those of the acquiring firms were significantly worse off. Moreover, the losses to the shareholders of the acquiring companies more than offset the gains of the acquired companies' shareholders, a result Firth suggested may reflect the transaction costs of undertaking the mergers. Last of all with respect to the UK, mention must be made of the massive study by Keith Cowling and his associates [1979]. They examined in detail the impact of mergers on 9 companies. As might be expected of the case study approach no single pattern of results emerged for all mergers. Some increases in market power were observed, some improvements in efficiency, some worsening of efficiency. Their overall conclusion, however, was that the negative effects of mergers at a minimum balanced out the positive effects. Society did not appear to be on net better off as a result of the mergers.

Donald Thompson [1979] reached a similar conclusion for Canada. An investigation of the post-merger profitability of 24 conglomerate mergers revealed 13 with improved performance, 11 with worsened performance.

Thus the evidence from Canada, the UK, France, West Germany, Belgium, the Netherlands and Sweden consistently points to the conclusion that mergers do not improve economic efficiency on net. These results place one in a bit of a conundrum, if one reaches the conclusion that mergers in the United States have led to improvements in efficiency. Canada and the European countries have had considerably more permissive policies toward mergers than the US has; and so managers in these countries have had more freedom to choose a merger partner they preferred. Not surprisingly in Europe at least, they favored partners in their own industry. Nevertheless, these mergers have on average not been successful. Can we expect mergers in the US to have been more profitable? Are the synergies of conglomerate expansion greater than the economies and market power advantages from horizontal mergers? Should we conclude that Congress spared US firms from engaging in this apparently unprofitable form of merger by amending Section 7 in 1950 and diverting companies to more profitable conglomerate mergers? Have managers in Europe been obtuse in not recognizing the superior efficiency gains from conglomerate acquisitions, as they persisted in pursuing horizontal mergers?

B. The Evidence from the United States

Fortunately the results for the US are sufficiently close to those just cited to allow us to avoid these conundrums. At least this was the conclusion I reached in a survey of the literature published in 1977. Although a couple of additional studies have appeared since then, they do not seem to alter the picture.

First of all, returning to Tables 1 and 2 we see from our international comparison study of the US that the effects of mergers appear to be neutral if not negative. Profit rate change comparisons yielded negative but insignificant results. The relative decline in sales was negative and significant (not shown). Rates of return on stockholder common shares fell continuously following the mergers when compared to the size and industry matched nonmerging companies. The returns on the shares of acquiring companies were significantly below the average returns earned on shares in their base industry.

The relative decline in common share performance we observed in one of our US comparisons and in several European countries has been observed by others for the US. Weston, Smith and Shrieves [1972] found that conglomerates outperformed a sample of mutual funds up through the peak of the late 1960's stock market boom. Melicher and Rush [1973] confirmed this superior performance by conglomerates up through the stock market's peak, but found that their relative advantage was completely wiped out during the first two years of the stock market's decline in the early seventies. As with our results for the international comparison study one had the impression that the decline in the conglomerates' relative performance would have continued had Melicher and Rush extended their data series.

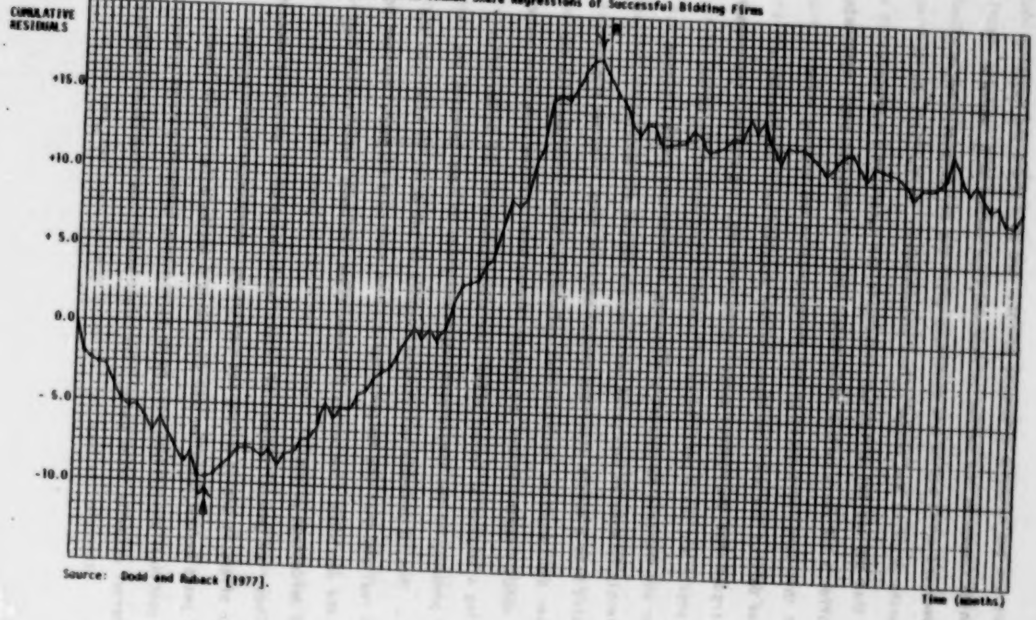
Mandelker [1974] also observed a gradual decline in the performance of the acquiring companies' shares over the 40 months following the mergers. Perphaps more interesting, Mandelker found that the acquiring companies' shares experienced a gradual and continual improvement in performance commencing some two years before the mergers.

The same pattern has been observed by Langetieg [1978] and Dodd and Ruback [1977]. Langetieg's study is a direct follow-up to Mandelker's using a similar sample. He attempts to control for other factors that might affect share performance, however, by introducing an industry factor, and a control group sample. Over the period from 6 years prior to the merger to 7 months prior, the acquiring companies earn significantly higher returns. The biggest increase in reutns comes over the period from 18 months to 7 months preceeding the merger, a rise of 7.72 percentage points. Starting 7 months before the merger the acquiring companies' shares begin to decline in performance. Their cumulative fall is 1.61 percent. During this 7 months the acquired companies shares rise dramatically. Thus, this 7 month pre-merger period appears to correspond to the period when news of the merger reaches the market. This news drives up the price of the acquired companies' shares, and drives down the price of the acquiring companies' shares. Following the merger the performance of the acquiring companies' shares continues to deteriorate although the differences from the control group samples are not statistically significant. Langetieg concludes that some motive other than maximizing stockholder welfare must govern merger activity.

Although Dodd and Ruback's results for tender offers seem similar to Langetieg's results for mergers, they reach the conclusion that tender offers have a positive impact on the shares of both the successful bidding and target firms. Figure 1 plots the cumulative residuals for the successful bidding firms against time, measured in months along the horizontal axis.[13] These residuals are from regressions of the returns of the bidding firms on the returns to the market portfolio. Normally they should hover around zero. Significant movements away from zero indicate market reactions to new information about the firm.

FIGURE 1

Cumulative Residuals from Common Share Regressions of Successful Bidding Firms



Source: Dodd and Ruback [1977].

There are two noticeable turning points: one at A where the negative drift, which commences the series is reversed, the second at B, where a slight downward drift begins and continues until the series ends. Point A is 43 months prior to the tender offers announcement. It is difficult to believe that the capital market can anticipate the nature of a successful tender offer 3 1/2 years before it is made. Thus, it does not seem legitimate to count this long improvement in the performance of the bidding firms' shares as part of the positive impact of the acquisition. The managerial theory argues that the reverse causality is involved. Substantial improvements in the profit and share performance of companies can reduce the threat of takeover and increase management's' resources to undertake an acquisition sufficiently to make an otherwise unattractive merger attractive.

Point B is 6 months after the tender offer is made. The results of Mandelker and Langetieg indicate that information about a merger hits the market about 7 months before the merger takes place. In the case of a merger following a successful tender offer, the announcement of the tender offer itself probably is the single most important piece of news to reach the market. Thus, B probably corresponds roughly to the point in time when the market realizes that the tender offer will in fact be a success. Between point B and the end ofthe time series the cumulative residuals experience a drop of 8.6 percentage points.

Thus, the general pattern of return performance of firms making successful tender offers is one of a long and substantial improvement starting some 3 1/2 years before the offer and concluding 6 months after it, followed by a continual and gradual decline in performance commencing roughly when the merger actually takes place. One might wonder how from these results how Dodd and Ruback reach the conclusion that the tender offers had a significant positive impact on the shares of the successful bidding firms?

Dodd and Ruback break the 10 years surrounding a tender offer into 5 time periods: (1) from 60 to 13 months prior to the offer, (2) the 12 months prior to the offer, (3) the month of the offer, (4) the 12 months after the offer (5) the period from 13 to 60 months after the offer. A glance at Figure 1 indicates that there is no reason suggested by the data for dividing the time around the merger in this way. Nothing different appears to be happening 12 months prior to the merger than was happening 6 months prior, or 24 months prior. The two logical division points in the time series are A and B. Dodd and Ruback's conclusion that the tender offer has had a positive impact appears to rest on 3 deductions (1) bidding firms' shares experienced positive and significant improvement in performance over the 12 months preceeding the announcement, (2) they also exhibited a significant increase of 2.82 percentage points in the month of the announcement, and (3) the cumulative residuals over the two time periods following the announcement of the tender offer, although negative, were not statistically different from zero. But it does not seem legitimate to attribute the improvement in the bidcing firms' share performance over the prior 12 months to the tender offer, since this improvement appears to be an extension of a trend starting 3 1/2 years ahead of the offer. Indeed, the positive residuals earned in the announcement month itself, and over the subsequent 6 months do not appear to be a significant deviation from this long run trend. I doubt if most observers would want to argue from this residual pattern that important news reached the market 7 months prior to B (but not at B), and that the residual pattern over these 7 months represents a significant upward deviation from the long run trend between A and B. Yet such an inference would seem to be required if one is to conclude that the tender offer's announcement has brought important, positive news to the market.

It is, of course, noteworthy that the shares of the successful bidding firms experienced a statistically significant improvement in performance of 2.83 percentage points. Thus, a shareholder who bought into a firm at the beginning of the month it made a tender offer and sold out at the end of the month would be almost 3 percent ahead. But, it is also noteworthy that if he did not sell out at the end of the month, but held the shares over the next 5 years, he would be nearly 3 percentage points worse off than if he never bought in at all. Moreover, if he made the mistake of buying in 6 months after the offer's announcement and held until the end of the period, he would be 8.6 percentage points worse off. I do not have the data to determine whether these declines are statistically significant. But even if there are not, that alone would suffice to reject the hypothesis that the mergers have had a positive impact. The only way one can conclude that the tender offers had a positive impact on the shares of the bidding firms is to add in a large fraction of the increase occurring over the 3 1/2 years preceeding the offer, and ignore all of the decline occuring after it.

Further indication that these pre-announcement gains are not part of the impact of the mergers is obtained by examining the cumulative residual pattern for the unsuccessful bidding firms. They too experienced a sustained improvement in performance prior to making their tender offers. The only difference in their pre-offer performance is that the improvement is not as long or dramatic. This pattern again suggests that it is the improvement in performance that precipitates the offer rather than the reverse.

Nielsen and Melicher [1973] found that the premiums acquiring companies paid in mergers were positively related to their own P/E's and cash flows. Perhaps, the unsuccessful bidders did not experience a sufficient improvement in performance to make them willing to undertake the transactions costs and offer the premium required to make the tender offer a success.

The post-offer performance of the unsucessful bidders' shares was also interesting. No gradual decline in cumulative residuals, as occurred for the successful bidders, was observed. They meandered around zero as might be expected under normal conditions. Thus, while some negative news appears to reach the market some 6 months after a successful tender offer is made, no news negative or positive is implied by an unsuccessful bid.

Kummer and Hoffmeister [1978] have also published results suggesting that the shareholders of both the target and bidding firms are better off as a result of the tender offer. As in the Mandelker and Dodd and Ruback studies they find a significant improvement in share performance for the bidding firms over the two years preceeding the takeover implying that the bid was precipitated by this share return performance. They also find a significant improvement in share performances over the 3 months preceeding and 1 month following the takeover. They do not extend their analysis beyond a month past the takeover, thus one cannot determine whether additonal time would have eroded these gains as occurred in the Mandelker, and Dodd and Ruback studies.

The studies by Dodd and Ruback, and Kummer and Hoffmeister focus on tender offers. Tender offers are a small fraction of all mergers in the United States. Presumably, the acquiring firms resort to this "hostile" form of acquisition only after considering and rejecting a "friendly" acquisition on the grounds that the target company's managers would not be receptive. Thus, takeovers are likely to involve the displacement of bad managers if any acquisitions do. The probability that they increase efficiency is greater than for other mergers, therefore. Whatever conclusions one draws from these two studies of tender offers, one should be cautious generalizing them to all forms of mergers in the United States. Given the alternative interpretation of these results presented above, I do not believe one can conclude that they overturn all of the evidence from the rest of the literature indicating that the stockholders of acquiring firms are no better and perhaps worse off as a result of mergers.

It is again worth emphasizing that the managerial theory does not hypothesize that all mergers are unprofitable, only some. Although I expect that the fraction of mergers that are unprofitable is large, it is possible that some studies will draw samples from the population of all mergers containing a predominant number of profitable mergers, particularly if the sample selection criterion favors such a selection. In judging the need for additional antimerger legislation, however, the key questions are: What are the net effects of all mergers, or what are the effects of those mergers that would be prohibited by new legislation? The overwhelming answer that emerges from the literature on acquiring firms, is that a substantial fraction of all mergers could be prohibited without any loss in economic efficiency.

If shareholders of acquiring companies have not faired very well, the same cannot be said of the shareholders of the acquisition targets. To transact an acquisition a substantial premium is usually paid for the target firm's shares, resulting in a handsome return to the shareholders of the acquired company. Many observers seem willing to conclude that the existence of these gains alone suffices to demonstrate that mergers improve economic efficiency. The argument runs as follows: Acquirers compete in a market for corporate control. The maximum price they are willing to pay for another firm is predicated on the expected gains from managing these assets. The market for corporate control is perfect, and all firms anticipate the same gains from acquiring a given firm. Bidding ensues. The price of the acquired firm rises to reflect the full gains expected from acquiring it. Perfect competition in the market for corporate control leads to all of the gains from merger accruing to the acquired companies' stockholders. If the shareholders of acquiring companies at least break even, society is better off by the full amount of gains to the shareholders of acquired companies.

Two things are wrong with this argument. First, the notion that competitive bidding for acquisition targets takes place does not fit the facts. Thompson's [1979] case study research on mergers in Canada revealed that two thirds of all transactions were initiated by the selling firm. Once negotiation was underway an "institutional ethic" against bringing in other buyers and sellers prevented any bidding from taking place. The same merger environment seems to exist in the United States. Seldom is more than one buyer involved, and very rarely more than two. Thus, the appropriate market analogy is not the competitive, Walrasian auction market, but a bilateral monopoly. Why then does the larger, economically more powerful firm always give up all of the gains from trade? How does the smaller seller always force the buyer back to its corner of the contract curve? Even if the fiction of competitive bidding is maintained, the assumption that the acquiring companies earn zero returns is inconsistent with the neoclassical assumption that their managers are maximizing stockholder welfare. The variance in the returns to acquiring firms from mergers appear to be quite large [Gort and Hogarty, 1970; Halpern, 1973]. Why do the managers of acquiring companies continue to make large investments for their risk averse shareholders that have zero expected returns and a high variance?

The second thing wrong with the argument that gains to shareholders of acquired companies constitute net gains to society is the assumption that the existing literature establishes that acquiring firm shareholders break even. Several studies cited already in this paper or in my earlier survey [1977] have concluded that the acquiring companies or their shareholders are worse off following the mergers. This conclusion can be reached for our international comparison study, for example, with respect to either profit rate changes or returns on common shares for Sweden, Holland, the UK and the US.[14]

The variance on the returns to acquiring companies from mergers are so large, however, that most studies have concluded that their effects, plus or minus, are not statistically significantly different from zero. These variances are probably large enough in most cases to wash out the gains to the acquired firms too. In our US sample, the acquired companies averaged 10 percent of the size of their acquirers, a fraction that is certainly larger than the average of all mergers. The median premium for the 6 studies Halpern cites was 21% [1973, p. 556]. Thus, the gains to acquired company shareholders are around 2 percent of the market value of the acquiring firms. It is more than likely that the large variances in returns that led to the conclusions that the mean returns to shareholders of acquiring firms are not statistically different from zero would also have sustained the conclusion that they were not statistically different from -0.02.

For example, in the Dodd and Ruback [1977] study the decline in the cumulative residuals for the acquiring firm between the month before the tender offer was made and 60 months after it, was 3.1 percent. The increase in cumulative residuals for the target firms over the same period was 27.6 percent. If the target firms averaged 10 percent of the size of their acquirers, the decline in value of the acquiring companies would fully offset the gains to the target firms. In Langetieg's study the acquiring firm shareholders experienced a loss of 1.61 percent during the 6 months preceeding the consummation of the merger, the acquired company shareholders a 12.9 percent gain. Again adjusting for relative size differences, the losses to the former are more than enough to offset the gains to the latter. Halpern's [1973] is the only study for the US, witn which I am familiar, that actually combines the results for the acquiring and acquired firms.[15] He concludes that the mergers are a success on the basis of a nonparametric test of the fraction of mergers yielding positive combined returns. While it is noteworthy that the combined returns to acquiring and acquired shareholders are positive more often than not, it is also interesting to note that the mean of these returns is but 1/6th of their standard deviation. Certainly such a large dispersion of results should lead one to be cautious about evaluating the economic significance of the returns from mergers, whatever their statistical significance. Caution is further warranted because Halpern bases his conclusions on the returns earned up to the date of the mergers, especially since several studies have observed declines in the returns on acquiring company shares over the post-merger period. Thus, I do not think it is possible at this time to conclude that the premia paid for acquired company shares constitute a net gain to shareholders as a group, and *a fortiori* that society is better off by this amount.

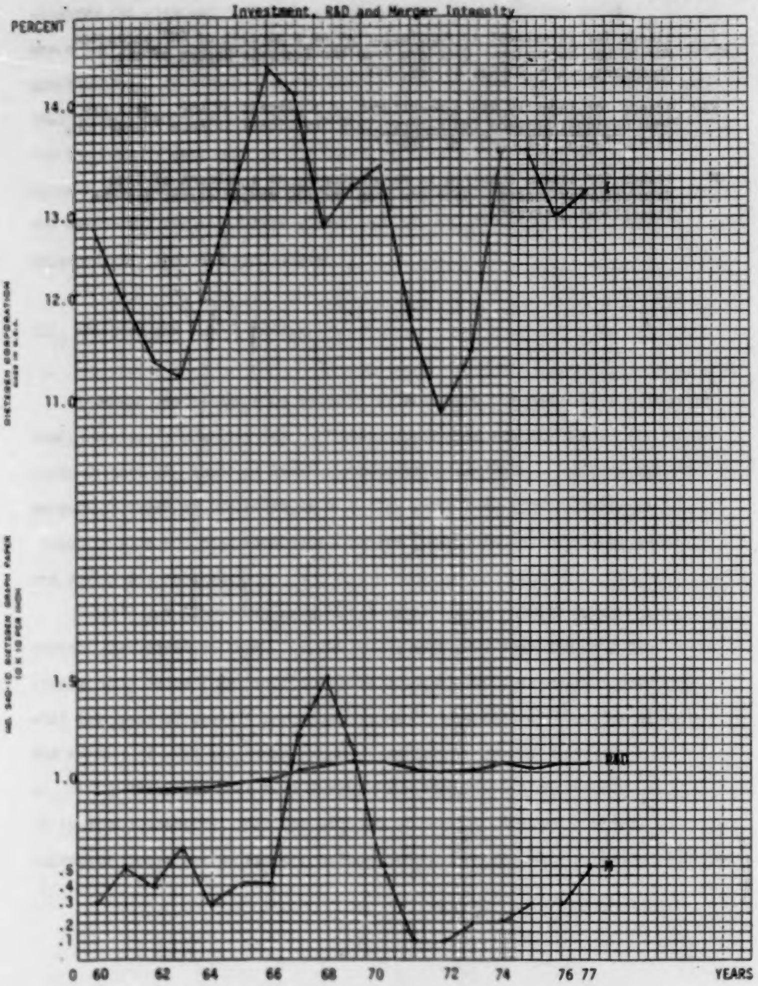
Although the literature focusses on the effects of mergers on individual companies, the key issue is, of course, their net, aggregate effect on corporate efficiency and the performance of the economy. Many claims have been put forward regarding the social gains from mergers. They are supposed to improve the allocation of capital resulting in both higher returns on and consequently more investment in new capital. This argument can be extended to investment in R and D. In addition, since conglomerate diversification reduces the riskiness of a company's asset portfolio, greater expenditures on risky investments like R and D should be encouraged. All companies should exhibit greater internal efficiency because bad managers are eliminated by the corporate takeover process. All managers should work harder to further their stockholders' interests and avoid becoming a takeover target.

Figure 2 depicts the intensity of merger activity, capital investment and R and D since 1960. It is difficult to discern any upward shift in the latter two series in response to the first. If any relationship exists at all, it appears that the three investments move together, perhaps in response to a common stimulus like cash flow and business conditions.[16] In particular no upward movement in investment and R & D in response either to the wave of the late '60's or the cumulation of mergers over these two decades is visible. Increases in productivity have been erratic, but since 1973 have followed a downward trend. Currently, the economy exhibits no improvement in productivity whatsoever.

Defenders of merger [illegible]ll quickly respond that many additional factors affect investment and productivity, and, I suppose, that the economy's performance would have been still worse had it not been for the beneficial effects of mergers. The government, we now all know, is run by power

FIGURE 2

Investment, R&D and Merger Intensity



Notes to Figure 2.

I stands for investment in manufacturing as a percent of GNP accounted for by manufacturing. Data are from the Economic Report of the President, 1979, Tables B4, B5, B45.

R&D stands for industry R&D expenditures as a percent of GNP. Data are from National Science Indicators, 1979 (National Science Foundation, 1979), Tables 2-2, 2-3, pp. 170-171.

M stands for assets acquired in manufacturing as a percent of Total Manufacturing Assets. Data are from the FTC merger series and the Statistical Abstract.

hungry politicians and budget maximizing bureaucrats, who together have expanded its size and influence on the private economy to the point where the latter can scarcely survive. If we would only break up unions, place constitutional constraints on bureaucrats bent on expanding their budgets, and then allow corporations to merge and grow without bound, all would turn out for the best in this best of all Pareto-optimal worlds. Perhaps. But, I think a skeptic is justified in demanding some more tangible evidence of the beneficial social effects of the more than 22,000 mergers that have occurred over the last two decades.

III. Mergers and Public Policy

Although the evidence on mergers' effects does not constitute a case for them, it also is probably not sufficient for a case against them. The latter rests in part at least on their socio-political effects. The case against mergers is based on the evidence that they contribute significantly to corporate size, and that corporate size and (undesireable) political power are positively related.

I shall not attempt to establish a relationship between mergers and overall concentration here. Let me simply emphasize that the only two studies with which I am familiar, which systematically attempt to determine what the level of overall concentration would have been without any mergers, and compare it with the level actually realized, conclude that much if not all of the increases that have occurred are attributable to mergers.[17] It is also noteworthy, that the only period in this century in which aggregate concentration appears to have fallen substantially is from the bottom of the depression to the end of World War II. This period also "happens" to be the only one of sustained economic expansion in the United States that has not coincided with heavy merger activity. One must assume that a substantial curtailment of mergers would also produce a secular decline in overall concentration.

Economists are probably not the best social scientists to answer the question of whether corporate size leads to political power. A recent book by noted political scientist Charles Lindblom [1977] argues the point quite forcefully. One might now ask defenders of corporate mergers to demonstrate that large corporations do not exercise political influence.

In addition to curtailing the growth of large corporations, new antimerger legislation could actually curtail the growth of government and its influence on the private sector of the economy. The existence of large and powerful corporations fosters the growth of government, and the kind of government-business partnership John Kenneth Galbraith [1967] so well described over a decade ago. The recent Chrysler bailout illustrates the point. Here was a company in need of a takeover if ever one was. Why were there no corporate bidders? Why did the market for corporate control not prevent Chrysler's management from leading the company as far down the road to bankruptcy as they did? The answer I think is obvious. Chrysler is just too big to be taken over by almost any other company. One of the advantages of size is the freedom from takeover. Singh [1971] has shown that growth through merger, even at some sacrifice in profits, can be better protection from takeover than maximizing the present value of assets. Once a company reaches the size of Chrysler, government intervention may be required to avert bankruptcy, where it would not if the company were much smaller.

The mergers that produced the Chrysler Corporation occurred some time ago. Any legislation curbing mergers today would leave existing size and other avenues to growth untouched. Is this fair or desirable? I do not see where the issue of fairness arises here. The right to merge is not one of those inalienable rights we have inherited from the Enlightenment. The corporation is a creature of the state, and the state can place any restrictions on the privilege to operate under this legal form it chooses. The state can deny corporations the privilege of merging in the same way it can deny them the privilege of contributing to political campaigns without necessarily being open to a charge of unfairness.

There are three reasons for singling out growth through merger for special treatment. (1) it is administratively the easiest form of growth to control. Thus, this constraint on corporate growth is the most compatible of all other policies one might consider with the goal of curbing the growth of government size and intervention. (2) Controlling corporate growth through merger is probably sufficient to produce significant reductions in overall concentration in the long run. (3) This policy seems unlikely to have an adverse effect on the performance of the economy. If policies attacking size and other forms of growth directly have these 3 characteristics, then they too should be seriously considered. But in the absence of such policy proposals, there is no reason to set aside consideration of an effective antimerger policy.

This point can be illustrated by again looking at the petroleum industry. Here is an industry dominated by large corporations, which possess and exercise political power.[18] Proposals to curtail this power and break up these firms have appeared from time to time, but have never survived the counterattacks of the target firms. An antimerger law would do nothing to the present power the petroleum companies have. But to maintain their size and influence into the 21st century they must and undoubtedly will undertake a substantial volume of mergers. This form of perpetuation of size and power would be prevented by a tough antimerger law, and it would prevent other firms from using mergers to expand and fill the places left by the decline of the petroleum firms.

From the numerous descriptions of the capital market's failures, which necessitate mergers, their crucial role in discipling and replacing bad managers, and the like, I sometimes get the impression that capitalism might be incapable of surviving were it not for this form of corporate transaction. Ironically, it seems the capital market, except when it comes to evaluating the future consequences of mergers, is among capitalism's least efficient markets. Our business schools apparently retain the best of their students to teach on their faculties, and send the rest out to work in business. Despite their incompetence these graduates rise to the top of their companies and cling on so that their unfortunate stockholders can be rescued only through an outside acquisition. To weed out these incompetants and keep capital flowing to its most productive uses in the economy,we need some 1000 mergers per year.

Perhaps I am only a naive, optimist, but I think our market economy is resilient enough to survive and even prosper without the corporate merger to aid it in achieving its allocational tasks. It must be remembered that the corporate manager is a bureaucrat acting in an institutional environment quite similar to that of his public counterpart. Just as the public bureaucrat will exceed the mandate given him to correct traditional market failures, the corporate bureaucrat can be expected to exceed whatever mandate he senses he has to correct the failures of the capital market and his fellow managers. The growth of the public and private bureaucracies over the course in this century are parallel manifestations of the same individual motivation functioning in an environment with similar institutional constraints. Those who, like myself, favor decentralized, market and democratic solutions to the fundamental allocation and distribution questions society faces, should favor rules which constrain the growth of both private and public bureaucracy. An effective antimerger policy would be one such rule.

Footnotes

1. [Benston, 1979; Mueller, 1969, 1977, 1979; Steiner, 1975, Chs. 2, 4, 5].

2. Weston and Mansinghka [1971] place the latter interpretation on their findings that the firms that grew by merger during the sixties to become "conglomerates" started out as relatively low profit companies.

3. The argument can go either way however. See Mc Eachern [1975].

4. See, e.g., Benston [1979, § 3, 4].

5. See, e.g. [Asquith, 1979; Dodd and Ruback, 1977; Halpern, 1973; Kummer and Hoffmeister, 1978; Langetieg, 1978; Mandelker, 1974].

6. See, Jorgenson [1971], and Jorgenson and Siebert [1968].

7. This literature is huge. For a survey see, Fama [1970].

8. If the mergers of today can be explained by the underevaluation of company assets by the market, what explains the mergers of the sixties?

9. Elliot [1973], Grabowski and Mueller [1972].

10. A great deal is made by proponents of neoclassical explanations of mergers out of the role the higher tax on dividends plays in explaining mergers. It should be recognized, however, that no loss in social efficiency will come from legislation banning mergers that have tax avoidance as their justification. Such mergers have purely redistributive effects. Personally I doubt that merger activity would come to a grinding halt if capital gains were taxed upon accrual at the same rate as dividends.

11. Here one must point out that the managerial thesis is not that all mergers are unprofitable only that some are, those on the margin. Thus, it is somewhat ambivalent as to what the average effect will be. But, if the average improvement is zero or negative the managerial theory is certainly supported.

12. Each country's results were obtained by scholars from the respective country. They are
Belgium: A.M. Kumps & R. Wtterwulghe
France: F. Jenny and A. P. Weber
Holland: H. Peer
Sweden: J.-O. Edberg and B. Rydén
W. Germany: J. Cable, J. Palfrey and J. Runge
U.K.: A. Cosh, A. Hughes, and A. Singh
U.S.: D. C. Mueller
For details see Mueller [1980].

13. These were computed by simply summing the figures for each month presented in their Table 2 (pp. 364-66). My figures differ slightly from theirs, but the overall pattern is the same.

14. See also Meeks [1977] and Firth [1979] for the UK; Hogarty [1970], Haugen and Longstieg [1975], and Mason and Goudzwaard [1976] for the U.S.

15. Firth's study [1979] does the same thing for the UK and reaches the opposite conclusion.

16. To discriminate between factors that move the 3 expenditures in the same direction and substitute and complement relationships one needs to set up a simultaneous equation model.

17. See, McGowan [1965] and the paper by Hay and Untiet in this volume for the US, and Hannah and Kay [1977] for Great Britain. My views on this are presented in [1977, 1979].

18. See, e.g., John Blair [1976].

References

Asquith, P. "Mergers and the Market for Acquisitions," mimeo, University of Chicago, 1979.

Benston, G. J. "Conglomerate Mergers: Causes, Consequences and Remedies," in Mergers and Concentration, Part 2, Hearings before the Subcommittee on Antitrust Monopoly and Business Rights, 1979.

Blair, J. M. The Control of Oil (Pantheon: New York, 1976).

Cowling, K., P. Stoneman, J. Cubbin, J. Cable, G. Hall, S. Domberger, and P. Dutton, Mergers and Economic Performance (Cambridge University Press: Cambridge, 1979.

Dodd, P. and R. Ruback, "Tender Offers and Stockholder Returns," Journal of Financial Economis, 5, Dec. 1977, pp. 351-73.

Elliot, J. W. "Theories of Corporate Investment Behavior Revisited," American Economic Review, 63 March 1973, pp. 195-207.

Fama, E. F. "Efficient Capital Markets: A Review of Theory and Empirical Work," Journal of Finance, 25, May 1970, pp. 383-417.

Firth, M. "The Profitability of Takeovers and Mergers," Economic Journal, 89, June 1979, pp. 316-28.

Galbraith, J. K. The New Industrial State (Houghton, Mifflin Co.: Boston, 1967).

Gort, M. and J. T. Hogarty, "New Evidence on Mergers," Journal of Law and Economics, 13, April 1970, pp. 167-84.

Grabowski, H. G. and D.C. Mueller, "Managerial and Stockholder Welfare Models of Firm Expenditures, "Review of Economics and Statistics, 54, February 1972, pp. 9-24.

Halpern, P. "Empirical Estimates of the Amount and Distribution of Gains to Companies," Journal of Business, 46, October 1973, pp. 554-75.

Hannah, L. and J.A. Kay, Concentration in Modern Industry (Macmillan: London, 1977).

Haugen, R. A. and T. C. Langetieg, "An Empirical Test for Synergism in Merger," Journal of Finance, 30, September 1975, pp. 1003-14.

Hogarty, T. F. "The Profitability of Corporate Mergers," Journal of Business, 43, July 1970, pp. 317-27.

Jorgenson, D. "Econometric Studies of Investment Behavior: A Survey," *Journal of Economic Literature*, 9, December 1971, pp. 111-47.

Jorgenson, D. and C. Siebert, "A Comparison of Alternate Theories of Corporate Investment," *American Economic Review*, 58, September 1968, pp. 681-712.

Kummer, D. R. and J.R. Hoffmeister, "Valuation Consequences of Cash Tender Offers," *Journal of Finance*, 33, May 1978, pp. 505-16.

Langetieg, T. C. "An Application of a Three-Factor Performance Index to Measure Stockholder Gains from Merger," *Journal of Financial Economics*, 6, December 1978, pp. 365-83.

Lindblom, C.E. *Politics and Markets* (Basic Books: New York, 1977).

Mandelker, G. "Risk and Return: The Case of Merging Firms," *Journal of Financial Economics*, 1, December 1974, pp. 303-35.

Marris, R. *The Economic Theory of Managerial Capitalism* (Free Press: Glencoe, Illinois. 1964).

Mason, R. H. and M.B. Goudzwaard, "Performance of Conglomerate Firms: A Portfolio Approach, "*Journal of Finance*, 31, March 1976, pp. 39-48.

McEachern, W. A. *Managerial Control and Performance* (Lexington Books: Lexington, Mass., 1975).

McGowan, J. J. "The Effect of Alternative Antimerger Policies on the Size Distribution of Firms," *Yale Economic Essays*, 5, Fall 1965, pp. 423-74.

Meeks, G. *Disappointing Marriage: A Study of the Gains from Merger* (Cambridge University Press: Cambridge, 1977).

Melicher, R. W. and D.F. Rush, "The Performance of Conglomerate Firms: Recent Risk and Return Experience," *Journal of Finance*, 28, May 1973, pp. 381-88.

Miller, M.H. and F. Modigliani, "The Cost of Capital, Corporate Finance and the Theory of Investment, "*American Economic Review*, 48, June 1958, pp. 261-87.

Mueller, D.C. "A Theory of Conglomerate Mergers," *Quarterly Journal of Economics*, 83, November 1969, pp. 643-59.

———. "The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence," *Journal of Banking and Finance*, 1, December 1977, pp. 315-42.

———. "Do We Want a New Tough Antimerger Law?" *Antitrust Bulletin*, 24, Winter 1979, pp. 807-36.

______, ed., The Determinants and Effects of Mergers: An International Comparison (Oelgeschlager, Gunn, and Hain: Cambridge, 1980).

Nielsen, J.F. and R.W. Melicner, "A Financial Analysis of Acquisition and Merger Premiums," Journal of Financial and Quantitative Analysis, 8, March 1973, pp. 139-48.

Schumpeter, J.A. The Theory of Economic Development (Harvard University Press: Cambridge, 1934).

______. Capitalism, Socialism and Democracy, Third Ed. (Harper and Row: New York, 1950).

Singh, A. Takeovers: Their Relevance to the Stock Market and the Theory of the Firm (Cambridge University Press: Cambridge, 1971).

Steiner, P. O. Mergers (University of Michigan Press: Ann Arbor, 1975).

Thompson, D.N. "Mergers, Effects, and Competition Policy: Some Empirical Evidence," mimeo, 1979, York University, Toronto.

Weston, J. F. "The Nature and Significance of Conglomerate Firms," St.John's Law Review, Special Ed., 44, Spring 1970, pp. 66-80.

Weston, J.F. and Mansinghka, S.K. "Tests of the Efficiency Performance in Conglomerate Firms," Journal of Finance, 26, September 1971, pp. 919-36.

Weston, J.F., K.V. Smith, and R.E. Shrieves, "Conglomerate Performance Using the Capital Asset Pricing Model," Review of Economics and Statistics, 54, November 1972, pp. 357-63.

Williamson, O.E. Corporate Control and Business Behavior (Prentice-Hall: New York, 1970).

______. Markets and Hierarchies: Analysis and Antitrust Implications (Free Press: New York, 1975).

APPENDIX II.—ARTICLE BY DAVID KOTZ: "THE SIGNIFICANCE OF BANK CONTROL OVER LARGE CORPORATIONS"

JEI *JOURNAL OF ECONOMIC ISSUES*
Vol. XIII No. 2 June 1979

The Significance of Bank Control over Large Corporations

David M. Kotz

Several studies in the past ten years indicate that banks have emerged as an important agency of potential control over large U.S. corporations. This article briefly reviews some of the major studies and discusses why mainstream economics has, by and large, ignored this development. It then examines some consequences of bank power that are of interest to economists.

The Evidence

During the first fifteen years of this century, there was widespread concern about the growing power of banks in the U.S. economy. The Pujo Committee investigation in 1912–1913 focused a great deal of publicity on the extent of influence that bankers such as J. P. Morgan and Jacob Schiff exerted over many of the largest corporations.[1] In the past decade there has been a resurgence of concern about bank power, but not within the economics profession. The apparently growing power of banks should not be ignored by economists if they hope to provide an adequate analysis of the U.S. economic system.

It was the House Banking and Currency Committee, led by Congress-

---

The author is Assistant Professor of Economics, University of Massachusetts, Amherst. This article was presented at the Annual Meeting of the Association for Evolutionary Economics, Chicago, Illinois, 29–30 August 1978.

man Arsene Pujo, which investigated the growth of bank power in the pre–World War I period, and it was that committee which again examined and publicized bank power in the 1960s. The late Wright Patman utilized the power of the committee and its Subcommittee on Domestic Finance, both of which he chaired, to require the major banks to disclose information about certain of their relationships with large nonfinancial corporations. The information gathered was published in 1968 in what became popularly known as the Patman Report.[2] This report provided the first comprehensive data on bank trust department holdings of corporate stock. Prior to the publication of that report, little had been known about the stockholdings of bank trust departments. The Securities and Exchange Commission had not required corporations to report instances of large blocks of stock held by bank trust departments, even if the bank held full voting authority over the stock, on the grounds that the bank was not the beneficial owner.

The Patman Report showed that commercial bank trust departments had become the major stockholders in the economy, with $160 billion invested in stock in 1968. Of the 500 largest industrial corporations (ranked by sales) in 1967, the report found that 147 had 5 percent or more of their common stock held by one of 49 top bank trust departments.[3] The report also disclosed that the 49 banks studied had 768 interlocking directorships with 286 of the 500 largest industrial corporations. Noting that large banks are also important suppliers of debt capital to nonfinancial corporations, the report concluded that "the major banking institutions in this country are emerging as the single most important force in the economy."[4]

The publication of the Patman Report stimulated further studies of bank stockholdings and influence. In 1971 the SEC published the results of its massive institutional investor study.[5] This provided a wealth of data on the stockholdings of several types of institutional investors, including bank trust departments, investment companies, and life insurance companies.

The SEC study found banks to be by far the most important institutional stockholders. Bank trust department stock portfolios were found to be concentrated in a relatively few stocks, with those of large corporations particularly favored. Among a sample of 54 corporations with equity values of one billion dollars or more in 1969, the study found that 18 had 5 percent or more of their stock held by a single bank trust department, and 17 had 10 percent or more of their stock held by three or fewer bank trust departments.[6] The report concluded that "large institutions, particularly banks, have the potential economic power to exert significant influence over many companies whose securities comprise their portfolios, particularly large companies."[7]

In 1973, under the leadership of the late Senator Lee Metcalf, two subcommittees of the Senate Government Operations Committee published *Disclosure of Corporate Ownership.*[8] A voluntary questionnaire was submitted to 324 large corporations, and data were reported on the leading stockholders in the 163 corporations that responded. The study focused attention on the large blocks of stock held by banks, particularly New York City banks, in the 163 responding corporations. Unfortunately, unlike the Patman Report and the SEC study, Metcalf's study was not able to obtain information on the banks' voting authority over stock they held.

The fourth major governmental examination of bank power over nonfinancial corporations in the past decade was published in January 1978 by the Subcommittee on Reports, Accounting and Management of the Senate Governmental Affairs Committee.[9] Since an article by the principal author of that study, Vic Reinemer, appears elsewhere in this issue, I shall not comment on it here.

The foregoing studies all observed the accumulation of large blocks of stock by bank trust departments. Whereas in 1929 less than one-tenth of outstanding U.S. corporate stock was held by financial institutions, by 1974 financial institutions held over one-third. Bank trust departments alone held 26.9 percent of outstanding stock in 1974.[10]

Two long-term trends explain the growing proportion of corporate stock held by bank trust departments. One is a shift in the form in which wealthy families hold their assets. Largely in response to changes in the income and inheritance tax laws, the wealthy increasingly have come to hold their wealth in the form of trusts since the 1930s. These usually are managed by bank trust departments. As the successive heirs to corporate fortunes have lost interest in performing the functions of a stockholder, other than to spend the dividends, the power to buy, sell, and vote stock often has passed fully to the bank that manages the trust.

The second factor is the rapid post–World War II growth of private pension plans and other employee benefit plans, most of which are managed by banks. From a level of less than $2 billion in 1945, bank-managed employee benefit fund assets grew to $214 billion in 1976. This rapid growth reflects workers' insecurity about retirement, particularly since the already meager pension benefits paid by the Social Security system were failing even to keep pace with inflation in the 1950s and 1960s. Banks have invested employee benefit funds largely in stock, over which the bank normally has full voting authority.

These trends have placed the major banks in possession of large amounts of stock. Bank trust department assets are highly concentrated; in 1976 the ten largest bank trust departments held 33 percent of all bank trust assets. Regional concentration also is very high; six of the seven largest bank trust departments are based in New York City.[11]

While the government studies mentioned earlier uncovered much data relevant to determining the extent of bank influence over nonfinancial corporations, none attempted to determine how many major corporations are significantly controlled by financial institutions. I recently did a study which attempted to do this.[12] My effort was in the tradition initiated by Adolf A. Berle and Gardiner C. Means in 1932 and the U.S. Temporary National Economic Committee (TNEC) in 1940.[13] Both Berle and Means and the TNEC classified the 200 largest nonfinancial corporations according to source of control. A company's stockholdings and directors were analyzed to determine whether any stockholder, or group of stockholders, appeared to have control. Control was defined as "the power of determining the broad policies guiding a corporation" (TNEC) or "the power to select (or reject) the board of directors" (Berle and Means).[14]

However, both of these studies considered only beneficial stockholders. The possibility of a corporation being controlled by a financial institution through stockholding (or other means) was not considered. This oversight was probably unavoidable, given the lack of relevant data available at that time.

Employing the TNEC's concept of control (the power to determine the broad policies guiding a corporation), I attempted to determine how many of the 200 largest nonfinancial corporations are controlled by a bank or other financial institution. I took account of financial institutions' holdings of stock in a company, provision of debt capital to a company, and representation on a company's board of directors. The full criteria used to classify companies were quite complex. Briefly stated, I classified a corporation as under "financial control" (that is, controlled by a financial institution) if one of the two following conditions was met: (1) a financial institution held 5 percent or more of the company's voting stock, with full or partial voting authority over the stock, and/or (2) a financial institution was the leading supplier of debt capital to a company that relied on debt capital to a substantial extent, *and* the financial institution was strongly represented on the company's board of directors.[15]

The full criteria employed were more complex than the above and took account of more information. For example, a company was not classified as bank controlled based on a 6 or 7 percent stockholding figure if an individual beneficial stockholder held a much larger block of stock in that company. Such a company would be classified as "owner controlled" by the beneficial stockholder.

In the pre–World War I period of widespread financial control, banks controlled corporations primarily through the banks' control over access to debt capital, not through stockholdings. The second criterion for financial control is meant to cover such cases. The first criterion takes account of the more recent phenomenon of the institutional investor. My criteria were designed to give a conservative estimate of the frequency of financial control over large corporations.[16]

Data for my study of corporate control were obtained from a wide variety of sources. These included the Patman Report, the SEC's institutional investor study, the 1973 Metcalf study, corporate proxy statements filed with the SEC, annual company reports to other regulatory commissions, Moody's manuals, Standard and Poor's *Corporation Records*, and Dun and Bradstreet's *Million Dollar Directory*. The study covered the period 1967–1969 so that the unique information contained in the Patman Report and the SEC's institutional investor study could be used.

Of the 200 largest nonfinancial corporations in 1969, I found 69, or 34.5 percent of the total, to be under financial control.[17] Commercial banks were found to be by far the most important financial institutions regarding corporate control. I found commercial banks to control 55 companies, or 27.5 percent of the 200 (including three companies jointly controlled with other types of financial institutions). Also important were investment banks, which I found to control 11 companies in the sample (including one case of joint control with another type of financial institution). The most important basis of financial control was stockholding. Of the 69 companies under financial control, the basis of that classification was a stockholding relationship alone (criterion 1) for 49 companies; a creditor relationship alone for 15 companies (criterion 2); both types of relationship for 4 companies (criteria 1 and 2); and other factors for the one remaining company.

The most powerful individual financial institutions regarding corporate control are shown in Table 1. A striking degree of historical continuity is evident. The Rockefeller-controlled Chase Manhattan Bank tops the list, controlling 16 companies. Two banks descended from the old Morgan interests, Morgan Guaranty Trust and Bankers Trust, together controlled 12 companies in the top 200.

The results of my control study show that a substantial proportion of the largest nonfinancial corporations are controlled by financial institutions, particularly by commercial banks. The continuing rapid growth of bank trust department assets suggests that bank control will become still more widespread in the future.

Since financial control has been defined in a passive sense, as the *power* to determine the broad policies guiding a corporation, one might ask how actively banks and other financial institutions exercise that power. For control based on a creditor relationship, this issue is not so hotly contested. Bankers often admit that they directly exercise influence over management decisions of companies heavily indebted to the bank, and loan agreements sometimes explicitly give a bank final authority in certain policy areas for the duration of the loan. However, spokespersons for the major banks often insist that they do not exercise any influence over corporations whose stock is held in the bank's trust department. They state that if the corporation's management takes a course of action of which the bank seriously disapproves, the bank's response is to sell the stock and purchase an alternative investment. However, there are reasons for doubting whether this practice is always followed. One reason is that, when a bank holds 5 or 10 percent of a large corporation's stock, selling out rapidly is likely to depress the stock price seriously, causing a capital loss for the trust account. Exercising influence over management may be a more ad-

Table 1. *Financial Institutions Controlling More than One Company among the 200 Largest Nonfinancial Corporations, 1967–1969*

Financial institution	*Number of companies controlled*
Chase Manhattan Bank, New York	16
Morgan Guaranty Trust, New York	7
First National Bank, Chicago	6
Bankers Trust Company, New York	5
Mellon National Bank, Pittsburgh	3
Kuhn, Loeb and Company, New York	3
First National City Bank, New York	3
Lehman Brothers, New York	3
Cleveland Trust Company, Cleveland	3
Lazard, Freres and Company, New York	2
U.S. Trust, New York	2
Wachovia Bank and Trust, Winston-Salem	2
Mercantile-Safe Deposit and Trust, Baltimore	2

SOURCE: David M. Kotz, *Bank Control of Large Corporations in the United States* (Berkeley: University of California Press, 1978), p. 111.

vantageous course from the bank's point of view. Second, a bank may be able to gain financially by exercising influence over certain corporate decisions, such as what bank will obtain the corporation's demand deposits, loan business, and employee benefit plan managing business. Furthermore, even if a bank does merely sell a stock when disapproving of management behavior and buy when approving, that in itself is an indirect means of exercising influence over corporate behavior, since the resultant movements of stock prices can be expected to affect corporate managements.

It must be admitted, however, that the extent to which large institutional investors exercise power today has not yet been satisfactorily determined. The SEC study devoted substantial effort to investigating this matter. It found institutions to be generally evasive when asked about the extent of "informal" efforts to influence portfolio companies, concluding that "the extent of their informal participation in corporate affairs remains largely unknown."[18] However, one can find few occasions in history when small groups or compact institutions, possessing a great and growing power whose exercise could bring substantial gains to the possessor, allow that power to remain unexercised for long.

Mainstream Economics and the Corporate Ownership and Control Issue

Before proceeding to a discussion of the consequences of bank power, I would like to comment on the neglect by mainstream economics of the broader problem of which the bank power issue is a part, namely, the problem of corporate ownership and control. While there are exceptions, most notably some writings on the so-called managerial revolution, on the whole mainstream economics has not dealt with the issue of corporate ownership and control. The reason for this neglect is the virtually exclusive focus on market relationships that any perusal of the "leading journals" will disclose.

Markets do, of course, play an important role in a capitalist economic system. The analysis of markets has yielded many insights into the workings of capitalism. However, an exclusive focus on the market has blinded economists to the existence and importance of types of economic relationships other than market relationships. In particular, relationships of ownership, and all relationships involving control and domination, are obscured by a focus on markets, especially competitive markets.

One of Marx's insights was the recognition that the market is not all there is to a capitalist economic system. According to Marx, the sphere of exchange (that is, the market) "is in fact a very Eden of the innate rights of man," where "Freedom, Equality, Property, and Bentham" rule.[19] That is, in the market the buyer and seller act voluntarily, with equal rights, disposing over their own property and looking to their own interest.[20] Marx, seeking the source of exploitation and domination, found it located, not in the market, but in a second, distinct sphere of capitalism, the sphere of production. It is here that, after the inputs have been purchased in the market, and before the end product is sold in the market, the process of transforming the inputs into a final product takes place in a very different environment from that of the market. Here one finds not seller and buyer, but capitalist and worker, the former exercising his right to manage, the latter expected to obey.

Mainstream economists find the institution in which production takes place—the firm—to be rather puzzling in certain respects. The reasons for its existence seem unclear. Why do these internally coercive entities exist? Why does anyone submit to obeying another? Why is the economy not based entirely on exchange? Insisting that it *is*, some have even tried to interpret the firm as consisting of continuously renegotiated contracts, thereby abolishing with the stroke of a pen the distasteful aspects of this embarrassing institution.

Once we look beyond the market, we find relationships of power and control in the economy. Not only within the firm, in its hierarchic internal structure, do we find such relationships, but also in the nonmarket external relations into which firms enter. The relationship between major stockholders or creditors and the firm's full-time managers is an example. Power is involved in such relationships. Once the stock is purchased or the loan made, the stockholder or creditor has power over the firm's managers, as does the manager over the laborer once the labor agreement is made. Mainstream economists, seeing only labor *markets* and capital *markets*, miss the important control relationships involved. As I shall argue, nonmarket control relationships, besides being worthy of analysis as important economic relationships in themselves, have consequences for the market sphere as well.

The foregoing is not meant to deny that, in the actual economy, a sort of power is exercised through market relationships. After all, the subfield of industrial organization is primarily concerned with the problem of "market power," which arises once we drop the assumption that markets are competitive. However, "market power" is a peculiar variety of power. Unless a product has no substitutes whatsoever and is a necessity, then even if only a single seller exists, the buyers retain a kind of free choice. They may be overcharged relative to average and marginal costs, but a neoclassical economist can argue that the buyer still is free to purchase only as much as will yield satisfaction equal to price for the marginal unit. The situation is not Pareto optimal, but it appears that no real *power* relationship exists, in the sense of someone being compelled to do something against his or her will. It is outside the realm of the market that genuine power relationships are found, and that territory is generally considered off limits to economists.[21]

One might wonder why mainstream economics focuses so strongly on market relationships, to the extent that the internal workings of that central institution of modern capitalism, the large corporation, come to appear mysterious and inexplicable and must be explained away as a giant set of continuously renegotiated contracts possessing a strange unity and stability. There are, I believe, two reasons for this passion for the market. The more innocent one is that, in analyzing the market, it is possible to bring to bear the tools of modern mathematics. These permit an elegance and rigor in economic analysis that yield great satisfaction to the practitioner, while capturing some of the prestige of the exact sciences. The analysis of nonmarket economic relationships requires historical investigation, detailed examination of institutions, and case studies and generalizations therefrom, all of which, unfortunately, are not so amenable to the use of modern mathematical techniques.

A deeper reason for the focus on the market has to do with the ideological function of the social sciences. While the social sciences serve various roles in our society, one of which is to explain society's workings, the social sciences also serve the role of justifying the society's basic structure. Those theories and approaches which have the effect of strengthening the case for capitalism, although that may not be the conscious aim of the social scientist, tend to be favored with money and recognition. Theories supportive of the basic system, even if critical of some details, tend to dominate in the economics profession.

By focusing on the market, mainstream economics emphasizes capitalism's greatest selling point. As even Marx noted, the market appears to embody such values as independence, liberty, and equal rights. It is ironic that, as the growth of giant, vertically integrated, highly diversified firms has progressively restricted the scope of the market, economists have increased their emphasis on the market as the sum total of capitalism. The centralization of authority in large firms, and even the centralization of power entailed in financial control of large corporations, can be argued to have advantages for efficiency and progress. Indeed, in the business complaints about the "unfair advantages" enjoyed by the more centralized Japanese version of capitalism, with its close cooperation among firms and between business and government, one can detect a note of support for such a view.

However, this line of defense of capitalism has a fatal flaw: It fails to discern an advantage for capitalism over its rival, socialism. Socialism, after all, brings the centralization of capital to its logical conclusion. Thus, the identification of capitalism with free markets—with the image of the individual freely choosing among alternatives, bossed around by only the invisible hand—has remained the most effective defense of the system. A casualty of this defense is the analysis of power relationships in modern capitalism, including the problem of corporate ownership and control.

Bank Control and Corporate Behavior

Bank control of corporations has potential implications for firm behavior. In this section I shall develop several hypotheses along these lines. At this point, I do not have a definitive, empirically tested theory to present. What I want to do is present some hypotheses, along with supporting arguments for them, in the hope of stimulating interest in further theoretical and empirical work in this area.

There is something to be learned from the historical experience of banker power during the pre–World War I period. Large corporations developed in the railroad sector soon after the Civil War. For a few decades most of the new giant railroad companies were run by owner-entrepreneurs such as Cornelius Vanderbilt. The leading bankers helped raise the capital needed by the rapidly growing railroads, and in the 1880s bankers began to assert influence over them. By the mid-1890s most of the country's major railroads were no longer run by owner-entrepreneurs but had come under the firm control of bankers, particularly J. P. Morgan and Jacob Schiff. Beginning in the late 1890s, bankers began to gain control over many of the newly emerging large corporations in manufacturing and mining, again displacing owner-entrepreneurs, such as Andrew Carnegie in the steel industry.[22]

Owner-entrepreneurs in railroads and industrials in the late nineteenth century tended to be very independent-minded and highly competitive. Given the only moderately concentrated market structures that prevailed prior to the great turn-of-the-century merger movement, the result was sharp fluctuations in prices and profits in many industries. As bankers asserted control, they encouraged changes in both policies and market structures aimed at replacing unrestrained rivalry with cooperation and stability. This change can be seen clearly in banker efforts to organize cartels among the major railroads in late 1880s, followed by mergers and consolidations among railroads imposed by bankers in the mid-1890s. In the steel industry, the imposition of banker control led to the replacement of sharp rivalry by a regime of stable price leadership under the domination of the Morgan-created U.S. Steel Company.

This banker emphasis on cooperation and stability can be understood as the consequence of an important difference between bankers and owner-entrepreneurs. A banker has a broad network of interests, ties, and investments in various firms and industries; the typical owner-entrepreneur is principally concerned with one company. While the owner-entrepreneur might hope to gain through a policy of outdoing and undoing his rivals, a banker can be expected to prefer a policy of "stable profits for all" rather than "profits for one at the expense of others."

In the modern setting it is still the case that major banks have diverse interests and investments in many firms and industries. Starting from this characteristic of banks, several hypotheses will be developed about the present-day consequences of bank control for corporate behavior.

Merger Behavior

In the great merger wave of 1898–1903, bankers played the leading role in encouraging, planning, and executing the great industrial combinations. In the merger wave of the 1920s, the leading bankers again actively promoted many of the most important mergers. In addition to the previously discussed banker emphasis on achieving stability and reducing competition that flows from the banker's varied interests, banker promotion of those two great merger waves also involved the pursuit of "promoter's profit." That is, the promoters of great mergers have often made large profits overnight from the increase in asset values that accompanies the merger. This historical record suggests the question: Do banks use their position of control over large corporations today to encourage and facilitate mergers?

Significant changes have taken place since the 1920s in the banking community and in the nature of mergers. Before the 1930s the leading banks engaged in both investment banking and commercial banking. Investment banks traditionally profit directly from the merger process, in that they receive fees for finding merger partners, managing tender offers, and arranging merger financing. In 1933 the Glass-Steagull Act separated investment banking from commercial banking, and today it is the major commercial banks which control many large corporations. Furthermore, a large and growing proportion of the post–World War II mergers have been of the conglomerate type, in which cases the drive to reduce competition is believed to be a less important factor.

Nevertheless, there are fairly strong grounds for an hypothesis that commercial banks encourage mergers in the present period. Bank motives to encourage mergers today fall under three headings.

THE STABILIZATION MOTIVE. It was explained above that a bank's broad network of interest predisposes it to favor policies and structures that will bring cooperation and stability among firms. Encouraging horizontal mergers is one logical outcome of such a predisposition, since growing market concentration should facilitate market cooperation and stabilize, as well as raise, prices and profits. More important for today's merger scene, the encouragement of conglomerate mergers also flows from this logic, particularly if horizontal mergers are expected to encounter antitrust obstacles. Conglomerate mergers create larger firms from smaller ones, and the empirical evidence indicates that stability of earnings is positively associated with firm size.[23]

THE PROMOTER'S PROFIT MOTIVE. A bank can gain promoter's profits from mergers in two ways. First, a merger may raise the price of the acquiring company's stock. In most cases of bank control today, the bank's trust department holds a large investment in the company's stock, so that a bank may gain promoter's profit by encouraging a company it controls to engage in an acquisition that will boost the acquiring company's stock value. Second, a bank may receive advance information about planned acquisitions by a company the bank controls, enabling the bank's trust department to make a timely purchase of the target company's stock, prior to the rise in target company stock price that usually accompanies takeover bids.[24]

THE SERVICE GROWTH MOTIVE. Unlike investment banks, commercial banks do not normally earn fees for arranging mergers; however, they can still advance their own business by encouraging mergers. Banks offer a wide variety of services to corporations, including provision of checking accounts, holding of corporate payroll tax deposits, making loans, and managing employee benefit funds. When a company controlled by a bank embarks on a merger program, the bank might expect to obtain the above types of business from the newly acquired subsidiaries. In this regard, the SEC institutional investor study found bank holding of a company's stock to be associated with the bank's provision of certain services to the company. In multiple regression analysis for a sample of 49 large banks, the proportion of a company's stock held by a bank was found to be a significant explanatory variable for the proportion of the company's loans supplied by the bank and for the proportion of the company's demand deposits held by the bank.[25]

An investigation by the Antitrust Subcommittee of the House Judiciary Committee found an example of commercial bank involvement in a corporation's merger program that illustrates some of the above arguments.[26] The example involves Gulf and Western Industries and the bank I found to have control over Gulf and Western, Chase Manhattan. In January 1964, Chase convinced Gulf and Western to open a line of credit with Chase. In the next six years, Gulf and Western's mergers became increasingly ambitious, transforming it into one of the major U.S. industrial corporations (ranked 33rd by assets at year-end 1969).

Chase provided short-term loans to Gulf and Western specifically to enable Gulf and Western to purchase the stock of takeover target companies. According to the subcommittee report, "one phase of the relationship included a flow of information from Chase about companies in which G&W had an interest, including suggestions for acquisition."[27] In return, Gulf and Western had new subsidiaries transfer their checking accounts to Chase, deposit payroll and withholding taxes with Chase, and transfer pension plans to Chase Manhattan's trust department. Chase also received a large share of Gulf and Western's growing loan business. Furthermore, Chase received inside information about Gulf and Western's acquisition plans, which would have enabled the bank's trust department to gain promoter's profits, as explained above.[28]

The Gulf and Western–Chase Manhattan example shows that banks sometimes encourage and facilitate a program of acquisitions by firms influenced by the bank. It is important to determine whether that relationship is an atypical, isolated case or an example of a common phenomenon. I am presently conducting a study of bank influence over the merger behavior of a large sample of large manufacturing companies for the Federal Trade Commission. I expect that this project, when completed, will help answer this question.[29]

If the hypothesis that banks encourage mergers by companies they control is valid, then the growth of bank control may be a contributing factor to the rise in aggregate concentration in the United States in the post–World War II period. Although merger activity is now well below the levels of the late 1960s, a substantial number are still taking place. In 1976, the most recent year for which data are now available, the Federal Trade Commission reported 1,441 mergers, up 17 percent over the 1975 total. There were 77 reported large mergers in manufacturing and mining in 1976, with $5.96 billion in assets acquired. (Large mergers are those for which the acquired company assets were valued at $10 million or more.) The number of large mergers in 1976 was exceeded during the post-1948 years (for which records are available) only during 1967–1970.[30]

Cooperation versus Rivalry

The traditional elements of market structure, such as seller concentration, product differentiation, and entry barriers, have substantial explanatory power for market conduct. However, few would claim that market conduct is fully determined by such traditional elements of market structure. High seller concentration and high entry barriers facilitate the informal cooperative price setting that can yield substantial monopoly profits. Yet, two industries with similarly high concentration ratios and barriers to entry may exhibit different degrees of success at price cooperation. An important hypothesis for consideration is that the presence of bank control over the leading firms in an industry encourages successful price cooperation.

As was indicated above, the historical experience of the pre–World War I period lends support to this hypothesis. J. P. Morgan advocated a policy of "community of interest" among competitors, regarding price competition as destructive and destabilizing. Judge Gary, whom Morgan placed in charge of U.S. Steel, held industry dinners at which he urged the others to follow U.S. Steel's prices, until government pressure forced a shift to more subtle methods. The steel industry, which before Morgan's intervention had engaged in frequent price warfare, became the symbol of stable, cooperative pricing.

As was argued above, the banker's wide interests and investments in many firms lead to a preference for cooperation and stability. This is most clear-cut if a single bank controls several firms in the same industry. In my study of control over the 200 largest corporations, I found that financial institutions associated with the old Morgan interests controlled three leading paper companies (International Paper, Crown-Zellerbach, and St. Regis Paper). I found Chase Manhattan in control of three airlines (Eastern, Northwest, and Trans World). The recent Senate subcommittee study, *Voting Rights in Major Corporations*, found Morgan Guaranty Trust to be the leading stock voter in 27 of the 122 large companies analyzed. There seems to be potential for the leading banks to encourage cooperative rather than rivalrous behavior within many industries.

This hypothesis does not refer only to industries in which a single bank controls several leading companies. The bank preference for cooperation and stability leads us to expect bank encouragement of cooperative behavior in industries in which only one leading firm is bank controlled, or in which several leading firms are controlled by different banks.[31] I am not claiming that bank control over the leading firms in an industry will assure stable cooperation. Powerful forces fostering rivalry and conflict are inherent in the capitalist market, and they can never be completely subdued. However, we hypothesize that bank control acts as a counterforce to the rivalrous impulse.

In an antitrust suit against the Cleveland Trust Company initiated in 1970, the Department of Justice charged that Cleveland Trust's relationships with four leading automatic screw machine manufacturers tended to lessen actual and potential competition among the firms.[32] The bank did banking business with the four companies, had a representative on the board of each, and held substantial blocks of stock in all four. The complaint charged that "Cleveland Trust consistently exercises the voting rights to these shares of stock to elect directors and to influence important management and policy decisions."[33] Unfortunately, this case was resolved by a consent decree in 1975, so the government charge was never evaluated in court.[34]

The Federal Trade Commission is currently pressing an investigation of possible anticompetitive consequences of the relationships between eight major banks and the nation's leading energy companies. This investigation may yield useful information about bank influence over competitive behavior in an important industry, although the success hitherto of the banks in delaying submission of documents suggests there may be a long wait for the results.

If this hypothesis about bank-encouraged cooperative behavior is valid, the growth of bank control over corporations would lead to an increase in effective monopoly power in the industries concerned, with a given level of market concentration. Some studies of the administered pricing hypothesis have found evidence that the administered pricing which is characteristic of highly concentrated industries has recently been spreading to less concentrated industries. There are various possible explanations for such a finding, of course, but the presence of bank control might be looked into as a possibly relevant factor.

Vertical Relationships

Another hypothesis based on banks' preference for cooperation and stability involves buyer-seller relationships among firms. Specifically, a bank might encourage a company controlled by the bank preferentially to sell its products to, or purchase inputs from, another company tied to the same bank. Such arrangements may bring greater stability for the firms involved, through establishing an assured source of supply for the buyer and an assured market for the seller. In some instances, a bank with a large investment in a company in financial difficulty might be tempted to encourage another company controlled by the bank to help out by increasing purchases of the problem company's products. This might be a feasible strategy if the buyer company is itself in a strong position.

This hypothesis is put forward more tentatively than the two preceding hypotheses. To carry out such a strategy, a bank would have to influence decisions not always made at the top levels of the corporate hierarchy, unlike merger decisions and the overall emphasis on cooperation versus rivalry. Such a strategy would also be likely frequently to encounter severe competitive pressure, when an outside company attempted to offer a better deal on a purchase or sale. Competitive pressures also tend to undermine a policy of cooperative price setting, but in that case the long-run benefits to each firm of continued cooperation are more obvious.

If this "informal vertical integration" hypothesis is valid, then the growth of bank control brings with it an expansion of a type of "planning," and a corresponding reduction in the role of the market, in resource allocation. Such stable buyer-seller relationships would have an anticompetitive impact through foreclosing competition in the supply and marketing of products. Opportunities for such bank-encouraged vertical ties certainly exist. For example, I found Chase Manhattan Bank to control two aircraft manufacturing companies, Boeing and United Aircraft, in addition to the three previously cited airlines.

Concluding Remarks

The growth of bank control of large corporations is important not only because of its implications for corporate behavior in the market. It also has implications for the prevailing degree of effective aggregate concentration of economic and political power.

The data on aggregate concentration indicate substantial centralization of power. The 200 largest manufacturing corporations held 60 percent of all manufacturing assets in 1972. The largest corporations wield great power, both economic and political. Their investment decisions greatly affect our modes of transportation, the household goods we consume, and the quality of the air we breathe. Their lobbyists have influence in every committee in Congress. Their executives and lawyers regularly take leave to fill top positions in the executive branch of government.

Many analysts try to play down the power of large corporations. Some advocates of the managerial thesis claim that the modern large corporation is now run by a new class of social servants who, although they possess power, use it merely to balance the interests of all groups in society.[35] The "people's capitalism" school argues that, due to the dispersal of beneficial stockholdings, millions of small shareholders are now the true owners of corporate America. In the latest version of this view, Peter Drucker argues that the millions of employees who are the beneficiaries of pension plans are the actual controllers of American industry.[36]

The evidence shows that the evolution of corporate stockholding, rather than reducing the concentration of power in U.S. society, is having the opposite effect. I found Chase Manhattan Bank to control 16 of the top 200 corporations. I found 46 of the top 200 corporations to be controlled by New York City financial institutions. Thus, when we take account of financial control of large corporations, the level of aggregate concentration is found to be even higher than the usual aggregate concentration ratios suggest. The large commercial banks have become the major holders of equity capital as well as major suppliers of debt capital. As the power of old-style individual owner-entrepreneurs has declined in U.S. society, the power of financial institutions has risen in their place.

Given the potential anticompetitive implications of bank power and its effects on aggregate concentration of power, one would hope the antitrust agencies would devote more resources to investigating this problem. The Federal Trade Commission's Bank-Energy Interlock investigation, mentioned above, is a good start. The effort to investigate bank power would be significantly facilitated if greater public disclosure of bank-corporate relationships were required. At present, only a limited amount of data on bank-corporate relationships is reported on a regular basis, and much of what is available is in a form not easy to utilize.

In 1975 the Interagency Steering Committee on Uniform Corporate Reporting, with representatives from all the major regulatory agencies, issued its "Model Corporate Disclosure Regulations." These proposed regulations would mandate regular public disclosure by corporations of their top 30 stockholders, including such nonbeneficial stockholders as commercial bank trust departments. They would also require disclosure of major creditor relationships and director interlock information. The adoption of these regulations by the major regulatory agencies would greatly facilitate the effort to determine just how widespread is bank control of corporations, and it would aid in studying its consequences.

Notes

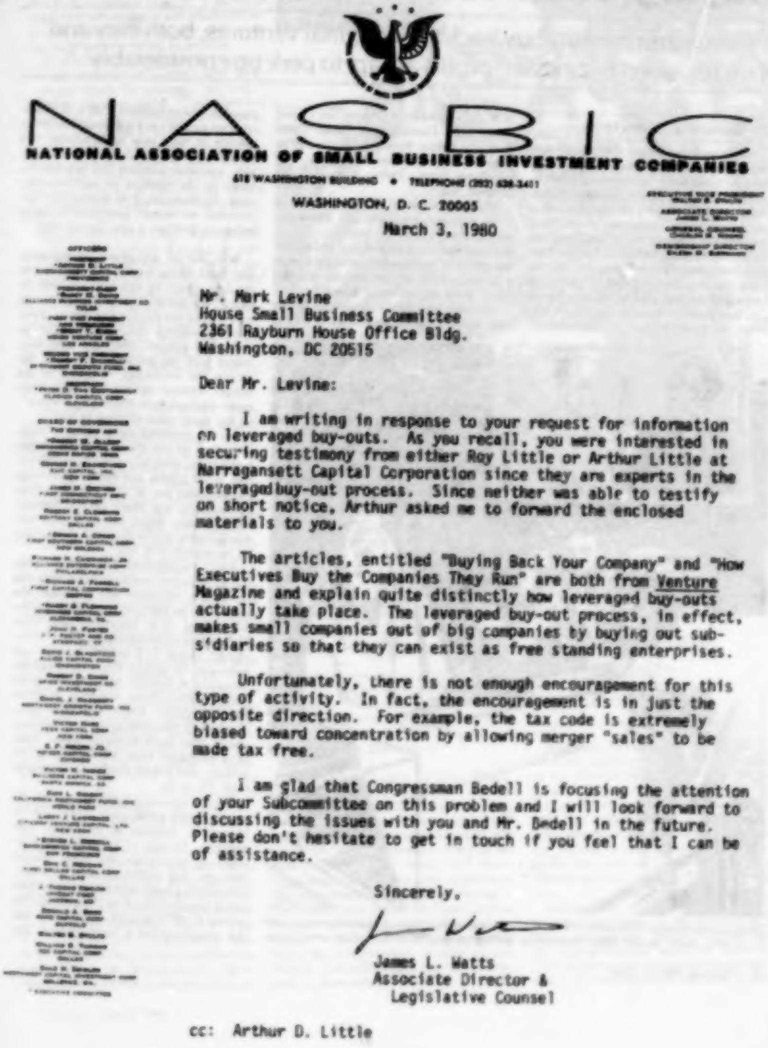
1. See U.S. Congress, House Banking and Currency Committee, *Report of the Committee Appointed Pursuant to H.R. 429 and 504 to Investigate the Concentration of Control of Money and Credit,* 62nd Cong., 2d sess. (Washington, D.C.: U.S. Government Printing Office, 1913).
2. U.S. Congress, House Banking and Currency Committee, Subcommittee on Domestic Finance, *Commercial Banks and Their Trust Activities: Emerging Influence on the American Economy,* 90th Cong., 2d sess. (Washington, D.C.: U.S. Government Printing Office, 1968).
3. Ibid., vol. 1, p. 3. Those figures include stock over which the bank trust department held no voting authority.
4. Ibid., vol. 1, p. 5.
5. Securities and Exchange Commission, *Institutional Investor Study Report,* House Document 92-64, referred to the House Committee on Interstate and Foreign Commerce, Washington, D.C., 1971.
6. Ibid., vol. 5, p. 2695. Those figures include only stock over which the bank trust department held sole or partial voting authority.
7. Ibid., vol. 8, pp. 124–25.
8. U.S. Congress, Senate Government Operations Committee, Subcommittees on Intergovernmental Relations, and on Budgeting, Management, and Expenditure, *Disclosure of Corporate Ownership,* 93rd Cong., 1st sess. (Washington, D.C.: U.S. Government Printing Office, 1973).
9. U.S. Congress, Senate Governmental Affairs Committee, Subcommittee on Reports, Accounting, and Management, *Voting Rights in Major Corporations,* 95th Cong., 1st sess. (Washington, D.C.: U.S. Government Printing Office, 1978).
10. Sources for those figures include the SEC *Institutional Investor Study Report,* vol. 6, pp. 78, 144; Securities and Exchange Commission, *Annual Report, 1975,* Table 7; and U.S. Federal Deposit Insurance Corporation, *Trust Assets of Insured Commercial Banks—1974,* p. 5.
11. The six are Citibank, Morgan Guaranty Trust, Bankers Trust, Chase Manhattan Bank, U.S. Trust, and Manufacturers Hanover Trust.
12. David M. Kotz, *Bank Control of Large Corporations in the United States* (Berkeley: University of California Press, 1978), chapter 4.
13. Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Harcourt, Brace and World, 1967; first published in 1932); and Temporary National Economic Committee (TNEC), *Investigation of Concentration of Economic Power,* Monograph No. 29, "The Distribution of Ownership in the 200 Largest Nonfinancial Corporations" (Washington, D.C.: U.S. Government Printing Office, 1940).
14. TNEC, *Economic Power,* pp. 99–100; and Berle and Means, *Modern Corporation,* p. 66. Notice that *control* is defined in a passive sense, as a power. It does not mean the day-to-day managing of a company.
15. Other control classifications employed, in addition to financial control, were owner control (by individual beneficial stockholders), no identified center of control, and a small miscellaneous category.

16. For a detailed justification of the control criteria I used, see Kotz, *Bank Control*, pp. 79–89.
17. The detailed results of this study are presented in ibid., Appendix B, pp. 157–91.
18. SEC, *Institutional Investor Study Report*, vol. 5, pp. 2762–63.
19. Karl Marx, *Capital* (Moscow: Foreign Languages Publishing House, 1957), vol. 1, p. 176.
20. This is an idealized picture of the market which, of course, does not perfectly correspond to the working of actual markets.
21. If we admit the possibility of imperfect information in markets, a seller, by misleading a buyer about the nature of the product, may in effect cause the buyer to do something against his or her will.
22. For a discussion of this history, see John Moody, *Masters of Capital* (New Haven: Yale University Press, 1919); and Vincent P. Carosso, *Investment Banking in America: A History* (Cambridge, Mass.: Harvard University Press, 1970).
23. Whether the greater stability of large firm profits is due to the risk-reducing effect of diversification or to other causes is an unsettled question. It should also be noted that excessively rapid growth through conglomerate mergers can create instability due to the difficulty of quickly integrating many previously independent and economically unrelated units.
24. A bank does not directly receive the gains in such cases; rather, they accrue to the trust fund for which the bank holds the stock. However, the bank does benefit from such gains in two ways. First, banks are normally paid a fee for managing trust funds that increases with the market value of the assets in the fund. Second, banks compete to some extent for trust accounts, and realizing such promoter's profits aids in keeping or obtaining accounts.
25. SEC, *Institutional Investor Study Report*, vol. 5, pp. 2747–48. The other significant independent variables were personnel interlocks, bank management of company employee benefit plans, region, company size, and bank size.
26. U.S. Congress, House Judiciary Committee, Antitrust Subcommittee, *Investigation of Conglomerate Corporations*, 92nd Cong., 1st sess. (Washington, D.C.: U.S. Government Printing Office, 1971), pp. 166–212.
27. Ibid., p. 171.
28. Ibid., pp. 169–70.
29. The results of that study should be available in the spring or summer of 1979.
30. The Federal Trade Commission's definition of a large merger as one for which the acquired company assets total $10 million or more is not adjusted for inflation. This imparts an illusory upward trend over time to the large merger series.
31. In the earliest stage of the development of bank control in the United States, the leading bankers sometimes engaged in sharp rivalries which led to behavior typical of owner-entrepreneurs. An example was the 1901 battle between Morgan-backed James J. Hill and Stillman-Rockefeller-backed E. H. Harriman for control of the Northern Pacific Railway.

However, by about 1907 the major New York bankers had largely ceased such overt rivalry. While it is possible that today control of the leading firms in an industry by different banks could encourage rivalrous behavior, the historical record suggests that it is more likely to encourage cooperative behavior.

32. *U.S.* v. *Cleveland Trust Company*, Civil No. C-70,301, Northern District of Ohio, complaint filed 3/26/70.
33. Ibid.
34. See *Antitrust and Trade Regulation Report*, 9 September 1975, No. 729, pp. A 19-A 20.
35. For example, see Carl Kaysen, "The Social Significance of the Modern Corporation," *American Economic Review* 47 (May 1957): pp. 311–19.
36. Peter Drucker, *The Unseen Revolution: How Pension Fund Socialism Came to America* (New York: Harper and Row, 1976).

Appendix JJ.—Material Submitted by the National Association of Small Business Investment Companies



NASBIC
NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES
618 WASHINGTON BUILDING • TELEPHONE (202) 638-3411
WASHINGTON, D. C. 20005

March 3, 1980

Mr. Mark Levine
House Small Business Committee
2361 Rayburn House Office Bldg.
Washington, DC 20515

Dear Mr. Levine:

I am writing in response to your request for information on leveraged buy-outs. As you recall, you were interested in securing testimony from either Roy Little or Arthur Little at Narragansett Capital Corporation since they are experts in the leveragedbuy-out process. Since neither was able to testify on short notice, Arthur asked me to forward the enclosed materials to you.

The articles, entitled "Buying Back Your Company" and "How Executives Buy the Companies They Run" are both from Venture Magazine and explain quite distinctly how leveraged buy-outs actually take place. The leveraged buy-out process, in effect, makes small companies out of big companies by buying out subsidiaries so that they can exist as free standing enterprises.

Unfortunately, there is not enough encouragement for this type of activity. In fact, the encouragement is in just the opposite direction. For example, the tax code is extremely biased toward concentration by allowing merger "sales" to be made tax free.

I am glad that Congressman Bedell is focusing the attention of your Subcommittee on this problem and I will look forward to discussing the issues with you and Mr. Bedell in the future. Please don't hesitate to get in touch if you feel that I can be of assistance.

Sincerely,

James L. Watts
Associate Director &
Legislative Counsel

cc: Arthur D. Little

Buying Back Your Company

When entrepreneurs buy back their original ventures, both they and their regained businesses' profits are apt to perk up considerably

By Edward J. Doherty

Many success stories simply end with the entrepreneur cashing in on the business he's nurtured for years and years by selling it to a large corporation. Sometimes, though, there's an epilogue when the entrepreneur reappears to buy back his original venture from conglomerate hands. In recent examples, Sidney Harman was scheduled, in February, to complete the buy-back of two of the three operations he had sold to Beatrice Foods Co. less than three years ago. Last October, the Sedutto family of Staten Island, N.Y., reacquired the Sedutto Ice Cream Corp. from Consolidated Foods Corp. And, just before New Year's Day, 1979, Vincent Rego purchased Capital Wire and Cable Corp., Dallas, from U.S. Industries, Inc.

While there are no figures available to show just how prevalent this phenomenon is, there can be no question that, in the overwhelming majority of situations, the return of the founding prodigy signals a reinvigoration of the enterprise—and often of the entrepreneur himself.

"It feels absolutely wonderful to be free again," says Rego, whose firm supplies wire to builders. "At U.S. Industries we couldn't use our creativity or act quickly to meet new opportunities. We were hampered by inventory, receivables, and other controls that had little relation to the realities of our business. Now, for example, I've invested $1 million that we weren't permitted to spend before to produce a new line of wire."

Why did an aggressive entrepreneur like Rego merge with a conglomerate in the first place? Of that time, in 1968, he says, "We thought that the conglomerate would even out the ups and downs of our cyclical business. But, in fact, we got flak instead of support when our sales fluctuated with the market." He adds that "even the exchange of stock in the merger worked against me, since their stock declined from $30 to $2 per share." (It has since risen to close to $10.)

At the corporation's behest, Rego stayed on to run the subsidiary. During that period, sales increased from $20 million to $32 million and earned an average compounded ROI of 11% per year. That performance was above the 4% industry average, says Rego, but he claims that management above him was demanding an unrealistic 15% ROI.

With management and entrepreneur fed up with one another, Rego recruited 15 minority investors and purchased the subsidiary he had sold for $30 million for $19 million. U.S. Industries took back $3.5 million in subordinated debt. The investors raised $1.5 million in cash and borrowed $9 million from the Teachers Insurance & Annuity Assn. in New York and $5 million from the First National Bank of Dallas. Rego, who now owns slightly less than 35% of the firm's equity, claims that since breaking away, sales have increased from $32 million to $58 million, and pretax profits have jumped from 7% to 9%.

Rego's improved performance on his own is hardly a precedent—even at U.S. Industries. Another of its former subsidiaries, Stroller of California, a manufacturer of strollers and other juvenile furniture, has tripled its sales volume to $30 million a year since entrepreneur Paul Smith bought it back in 1976. Smith had retired in 1973 because of conflicts with the conglomerate's management, bu

Their experiences at Consolidated Foods Corp. convinced Tony Sedutto (insert l.) and his father, Jack, to sell their commercial ice cream in a New York City retail store when the subsidiary began to lose money, he arranged to buy it back. According to Smith, his industry requires a personal touch in both customer and employee relations. Such sensitivity, he maintains, the conglomerate failed to provide.

At about the time that Smith was reassuming command of Strollee after a retirement which he claimed "to love," another conglomerate, Consolidated Foods Corp., was deciding to divest some smaller operations to concentrate on its large, consumer-packaged goods companies. What this meant to Jack Sedutto and his son, Tony, was that the ice cream company built up by their family would melt away if they didn't buy it back themselves.

Sedutto Ice Cream Corp. was founded in 1922 by Jack Sedutto's father, an Italian immigrant, and was built up by the second generation of four Sedutto brothers until it had an outstanding reputation within an 80-mi. radius of New York City as a supplier of high-quality ice cream to institutions. After two of the brothers retired, the family decided in 1971 to accept a $1 million-plus merger offer from Con Foods.

But unlike Rego and Smith, Tony Sedutto speaks favorably of his experience in the conglomerate world. "We became a division of Sara Lee at Con Foods and suggested marketing a Sara Lee ice cream to consumers," says the firm's treasurer. (Jack Sedutto, Tony's father, is president.) "Although management eventually killed the idea, it did support a successful two-year national test marketing campaign that later encouraged us to go into the consumer market on our own. At Con Foods we also acquired the useful habit of preparing detailed monthly and quarterly reports and budgets and learned to look at the business more objectively."

Last October, the Seduttos bought their company back for a little more than $1.5 million after spending what Tony Sedutto recalls as "14 hectic months trying to get financing so we could save our company." The family obtained a low-interest loan of $800,000 through the Industrial Development Agency, a public assistance corporation created to retain business in New York. IDA raised the money by selling a tax-exempt bond to Chase Manhattan Bank. Con Foods also took back a $300,000 note and the Seduttos paid the rest themselves.

Although the ice cream operation grew at a good clip of 15% to 20% per year at Con Foods, growth has accelerated by about 50% since the Seduttos struck out on their own. They attribute this to their entry into the consumer market. Last May, while buy-back negotiations were still in progress, they opened their first ice cream store on Manhattan's West Side—and it has been a stunning success.

Vincent Rego holds the wire that, he says, U.S. Industries wouldn't allow him to test

Sales are expected to reach $300,000 by the end of their first year of operations in May, 50% above expectations. Now Sedutto Ice Cream Corp. is constructing a new 17,000 sq. ft. office/plant building and will increase its employees from 55 to 100.

Of course, any company that flies personal ice cream orders direct to the Duchess of Windsor and that refreshed the palate of Pope John Paul II when he visited New York City last fall has got to have something going for it.

Another beneficiary of Con Foods' management strategy was Martin Granoff. He, like the Seduttos, was pushed out of the nest—and right into a pot of gold. Granoff had parlayed $5,000 into a $35 million company, Vald'or Industries, Inc., New York, that made brand-name knit shirts and distributed them to national and foreign wholesalers. But Granoff sold out to Con Foods in 1974 because, he said, he wanted financial security for himself and for his firm. But when the conglomerate decided to sell Vald'or, Granoff bought part of his firm back in September, 1978.

Eight years at Con Foods taught the Seduttos how to work with regular budgets

Although Granoff says the shirt business had stagnated at Con Foods because of the 1974-1975 recession, Vald'or has grown "by leaps and bounds" since regaining independence. Sales were up from $10 million to $14 million by last September and Granoff predicts a jump to $19 million by this coming fall. Pretax profits are over the 5% to 6% industry average and ROI, he claims, is better than 25%.

Unlike those who sell their companies to enjoy retirement or the security of a larger corporation, Sidney Harman left the entrepreneurial arena in January, 1977, when he was appointed Under Secretary of Commerce in the new Carter

Administration. Harman, a Ph.D. in social psychology, gained attention for his efforts to involve workers in management decisions.

To avoid any conflict of interest as a government official, Harman, who owned about 40% of the stock in Harman International Industries, Inc., sold the firm to Beatrice Foods in August, 1977. Harman shareholders received 1.42857 shares of Beatrice for each of the 2.7 million shares of Harman. Since the Beatrice stock was then worth about $23 per share—compared to $35 per share for Harman—the transaction totaled approximately $89 million.

But after two years at the Commerce Dept., Harman says, "I had enough of the ceremonial duties that gobbled up much of my time." By the time he resigned from government in December, 1978, the profitability of the Harman hi-fi operation had declined markedly because of international competition in the audio industry. Another Harman venture, his automotive mirror operation, continued to do well, though. Harman and Beatrice reopened talks and the result is Harman's recent re-entry into the high fidelity field with the $55 million acquisition of James B. Lansing Sound, Inc., a loudspeaker producer, and the Harman International network of electronics distributors. Although Harman invited some managers of the two firms to join him in the purchase, his plans called for closing the deal on Feb. 28, regardless of how many sign on.

Harman has been through the cycle of withdrawal and return once before. In 1963, he "retired" after negotiating a merger of his Harman-Kardon with the Jerrold Corp. in 1962. "After three days I couldn't stand retirement any more," says Harman. He joined an automotive accessory manufacturer, until he was called to government service.

Harman is, in fact, still talking with Beatrice about the possible acquisition of other divisions of his former company, including the Tannoy Group in Great Britain and Ortofon, the Danish cartridge manufacturer. Beatrice has already sold Harman-Kardon—the entrepreneur's first venture—to Shin Shirasuna Electric Corp., a Japanese firm.

When entrepreneurs such as Harman return to the helm of their companies, the result is apt to be the explosive growth demonstrated in the cases above. J. Jordan, who manages leveraged buyout operations for the New York investment bankers, Carl Marks & Co., Inc., feels that even reluctant entrepreneurs perform superbly when they reassume proprietorship "because no matter how hard he thinks he's working at a conglomerate—the entrepreneur puts a lot more energy and imagination into the firm when it's his own again and he can see the value of his equity increasing every day." ■

How Executives Buy the Companies They Run

Managers are taking over unwanted businesses from parent firms and showing they know how to run them themselves

By Winston Williams

Hundreds of corporate managers are becoming entrepreneurs these days without changing their routine, their business or even their office. It happens when they buy the company or the division or the subsidiary they had been running for someone else, sometimes a major corporation which finds its priorities shifting. And more often than not the castoff operation shows new life under its newly entrepreneurial management.

Take Incom International Inc., a $150 million manufacturer of industrial parts, headed by Edward G. Mabbs, 57, chairman and chief executive, and one of Incom's 17 owner-managers. Three years ago the managers ran the same business as a division of Rockwell International Corp.

When the last recession stretched the flow of Rockwell's cash, the giant aerospace conglomerate decided to improve its liquidity by "divesting" a group of companies that didn't "fit our high technology plans," as former chairman Willard Rockwell put it. But potential buyers were scarce, so Rockwell turned to the division's salaried managers, who had their own proposal to buy the business for $92 million.

The managers, who each earned between $50,000 and $80,000 a year, eagerly took second mortgages on their homes, borrowed against life insurance and from relatives to raise about $4 million in equity. Pledging the assets of the new company, they borrowed another $70 million. Insurance companies and venture capital firms kicked in another $18 million, receiving in return over 50% of the stock, on which the managers have first refusal rights if the firms decide to sell.

With Incom about to celebrate its third anniversary, Mabbs says that the company's profits have improved since the separation from Rockwell, making it possible to pay off the company's debt more rapidly. Incom is also toying with a new acquisition. Mabbs and the other investor-managers see themselves making a handsome profit on their stake eventually either by paying themselves a fat dividend or by selling their shares to the public or to another corporation.

"It's hard to say exactly when we'll get that far," says Mabbs, "but we're having an awful lot of fun trying." A Cornell-trained engineer, Mabbs had been with Rockwell most of his career before the "buy-out."

The saga of Mabbs & Co. is no isolated case. In the past few years some of the biggest names in corporate America have spun off similar opportunities, in the form of "leveraged buy-outs," to groups of managers. Among the sellers are Borg-Warner, International Telephone and Telegraph, FMC Corp., Allegheny-Ludlum Industries, Wheeling-Pittsburgh Steel, El Paso Natural Gas and W. R. Grace.

"There's nothing new about this type of financing but its growth has really taken off in the last few years," says Frederick S. Gilbert, Jr., vice-president of New York's Citicorp. "It's an alternative to capital at a time when capital is in short supply."

No one keeps statistics on leveraged buy-outs but the department which was set up three years ago by Citicorp Industrial Credit to finance such ventures has doubled its business each year. It has already disbursed well over $100 million to such ventures. Most deals are in the $1 million to $20 million range but occasionally go up to $50 to $60 million.

In addition to a good supply of willing lenders, the trend toward leveraged buy-outs is being accelerated by several other factors. Buyers and sellers list them as follows:

- Many diversified companies are striving for a more compatible product mix. Consequently they are selling businesses that are unrelated to their main products. Between 1970 and 1976 divestiture increased from 27% of total acquisition activity to 55%.
- The depressed state of the stock market in the late 1970s has made it impractical for companies to raise capital by issuing stock.
- Sellers want cash. In the late 1970s cash payments have accounted for 50% of all merger and acquisition payment, up from 30% earlier in the decade.
- Venture capital firms and small business investment companies would rather finance established businesses than take the risks associated with starting a completely new company.
- Regional development agencies are willing to participate in buy-out financing when the purchase will prevent the closing of a plant and the loss of jobs.

The trend could be slowed by unfavorable economic conditions, of

Adolph J. Lena, center foreground, with 13 of 35 managers who bought what is now Al Tech Specialty Steel Corp. Lena is chairman and CEO.

[illegible]

'It's difficult for a seller to get top dollar from key managers. Those guys know where all the skeletons are buried'

course. Further tightening of credit by the Federal Reserve could dry up funds for financing, even though a money crunch similar to the one in 1974 would probably increase the supply of corporate divisions on the auction block.

Nevertheless, the prospect of a long and profitable future for the leveraged buy-outs is attracting more banks, investment firms and other lenders into the business of brokering and financing these corporate separations. General Electric Credit, Walter E. Heller International and Aetna Business Credit are among the leaders in the field.

Regional banks have tended to shy away from this type of financing, leaving plenty of room for Citicorp and First National Bank of Chicago, the most aggressive big banks in the buy-out game.

The old line investment banks have also been slow to enter the field. But in 1976 three former employees of Bear Stearns and Co. put together the firm of Kohlberg, Kravis and Roberts, which has arranged two of the largest buy-outs on record, including the Incom deal. Gibbons, Green & Rice, which arrived on Wall Street in 1969, is also prospering from buy-out accounts.

Despite its popularity the buy-out phenomenon is much misunderstood. Nonfinancial managers want to know, "How can someone buy a business with so little equity?" Bankers ask, "How can a prudent lender countenance debt-to-equity ratios of up to ten to one?" And skeptics reason that companies want to sell only those divisions that do not earn a profit or that have no future.

Buy-out enthusiasts argue that each sale is different and that the details of a deal have to be studied to see why it makes sense.

When Willard Rockwell was desperately in need of cash, he began courting members of the Mellon family with overtures of a marriage between Mellon-controlled *Gulf* Oil Corp. and Rockwell International. Before the Justice Department could begin stomping its feet in protest, executives at Gulf, knowing Rockwell's talent for gobbling up large companies, became suspicious. Fearing that it would become a division of a new, gigantic Rockwell Oil Company, Gulf stalled. Needing cash in the meantime, Rockwell turned to the Eurodollar market for a sizable but costly loan. He also began negotiating to sell the conglomeration of gear, chain and controls plants that now make up Incom.

After the terms had been nailed down, the notes and the papers transferring the assets to Incom were signed simultaneously. Within months Incom set up headquarters five miles from Rockwell's high-rent suites in Pittsburgh's U.S. Steel building.

The managers, in return for risking their security at Rockwell and in recognition of their management skills, got a substantially greater share of the equity than the 20% they paid for. Thus did the new company begin.

"We wondered whether our customers and suppliers would stick with us. We asked ourselves whether we could make the transition from Rockwell and meet all our obligations," Mabbs says.

Incom held onto customers by continuing to market its filters, gears and controls by their previous brand names and by holding down sales and management turnover. Incom quickly divested a small German engine company and a maker of cotton-processing equipment. In hard bargaining Rockwell had insisted that Incom take these plants as part of the bargain, which also stipulated Incom's paying a premium above book value for the group.

Mabbs set out to cut overhead and to improve collection from customers. He says the divorce from Rockwell has speeded up decision-making and increased the company's market flexibility, which has made Incom more profitable.

"Buying managers often feel that if only they could get out from under the large, burdensome parent, they could spend their time selling instead of filling out reports," says Robert S. MacDonald, vice-president of Aetna Business Credit, Inc.

Buyers have a chance at making better profits when they purchase assets for less than their book value. In the summer of 1976 Allegheny-Ludlum sold its stainless bar division in Dunkirk, New York to managers. Because the competition from imported steel was so fierce at the time, the seller was convinced that the plant did not have much of a future. Consequently the group of 35 management employees who bought the business got it for about half its book value, or for $24.4 million.

If sales and profits had not improved at all, the low sales price would have automatically improved the profitability ratios. Return on investment would go up because the new company, Al Tech Specialty Steel Corp., carried its investment on the books at cost rather than at the higher valuation that the former parent had attached to it. Return on equity would automatically get a boost from the fact that the equity base was so small. The Al Tech managers paid only $1 million of the purchase price. Another $2 million came from bank borrowings. The Economic Development Administration loaned the managers $10 million at 5% interest in order to save jobs in New York State. Al Tech paid Allegheny Ludlum the remainder of the purchase price in notes and preferred stock.

Now the specialty steel business has become more profitable since import quotas were imposed on most specialty products and after several domestic firms made their exit from the market. Al Tech credits these factors with enhancing its profitability.

Like Al Tech, many of the corporate properties being put up for sale are in troubled industries. FMC has divested its money-losing synthetic-fiber business to managers. Western Pacific Industries has voted to sell its rickety railroad to a public company formed by the railroad's managers.

Photograph for VENTURE by John Alexandrowicz

Edward G. Mabbs ran Incom first for Rockwell, now for himself and 16 other managers

GAF, with some financing by the state of Vermont, sold its Vermont Asbestos Group to managers to keep from spending $1 million on pollution-control equipment. And Borg-Warner and Wheeling-Pittsburgh have similarly unloaded ailing steel divisions.

In such situations lenders tend to look more at cash-flow projections than the value of the assets, which may be old or on the verge of obsolescence. Often the loans are the "evergreen" type, which require that for a specified term only interest be paid, after which payments on the principal must be made.

Some critics of buy-outs regard the concept as a sophisticated form of asset stripping. They argue that large debt requirements will dry up funds for modernization and expansion and for research and development, leaving these companies without futures.

Dr. Adolph J. Lena, chairman of Al Tech, vigorously disputes this view. "The ratios may look out of line but it's not because our debt is so high. It's because our equity is so low. We generate enough internally to pay off our debt and by not paying dividends we can still modernize." Since its beginning two-and-a-half years ago Al Tech has earmarked $25 million for new furnaces. The furnaces will increase steelmaking capacity and lower the company's unit production costs.

At any rate, the controversy over asset stripping and the often illiquid nature of plant and equipment have convinced the more conservative lenders to shy away from plant and equipment as collateral, even though interest on buy-out loans is lucrative, ranging from 2% to 6% above the prime rate.

Citicorp, for example, prefers to base its loans on receivables due from businesses and on inventory. On the average the bank will lend 80% against receivables and 30% to 50% on raw- and finished-goods inventory.

Consequently, Citicorp is more committed to financing buy-outs of warehouses and distributorships than industrial production. The bank casts a stern eye on proposals to fund high-technology ventures, drug companies, construction companies and retailers. "Our companies aren't all that glamorous. They just have to be viable," says Citicorp's Rick Gilbert. Hardly anyone will consider financing a service company.

Despite the lack of enthusiasm from most lenders, some consumer-oriented companies have managed to strut across the buy-out stage. Edwin Roth, president of the Airport Parking Co. of America (APCOA) raised $10 million from a venture capital firm and from lenders to buy ITT's 403 parking lots. Perhaps partly because several layers of management have been eliminated, APCOA, with revenues of more than $100 million, is making more money than it did when it was a closet in the house that Harold Geneen built.

Not all buy-outs are successful, of course. Some have gone from bad to worse. A school furniture division that Brunswick Corp. sold to managers in 1971 has since been resold at a substantial loss. Cobblers, Inc., a shoe manufacturer, fell onto hard times after it was sold to management in 1971, but no buyer has come forward to take over the troubled business.

If there is one theme that both lenders and brokers stress constantly, it is that the spinoffs must have first-rate management that is willing to take a stake in the company for the long haul. Most investors will not participate in deals that involve bringing in new managers, and most say they need the managers' knowledge to make decent investment decisions.

"It's difficult for a seller to get top dollar from key managers," says Samuel Garvin, executive vice-president of the Pennsylvania Financial Development Corporation. "Those guys know how much the assets are worth. They know where all the skeletons are buried." But once the buy-out is accomplished, the new owners may not be in complete control.

After the buy-out the outside investors usually monitor the company's performance on a daily basis and often they control the board. Nevertheless, the owner-managers find themselves deeply in dept and often putting in 12-to 15-hour days.

Still, some managers think that their sacrifices and their risks are too great to have to share the company's equity with their financiers. Some venture capital firms have fashioned schemes that allow the managers to retain all the equity.

Although buy-outs have been generally successful the coming months may test the durability of the concept. The economic slowdown that many economists expect in 1979 could mean trouble for some of the fledgling enterprises.

Another worry is that the Federal Reserve may ask its member banks to stop making "non-productive" loans. The idea is that funds should be available for the purchase of homes, cars and appliances and for investment in new plants and equipment.

However, most observers think that any slackening of buy-out activity will be temporary. A business slowdown, they reason, would again create liquidity problems and produce a rerun of the conditions that caused management buy-outs to soar after the last recession. ■

S-79 08093

How I'm Deconglomerati

In 1959, three years before my retirement, the Textron directors gave me permission to organize a small-business investment company called Narragansett Capital Corp. Textron has come to be famous as the first of the so-called conglomerates, but I had started the company on less than a shoestring in 1923, and had struggled with inadequate financing for more than a dozen years before I was able to raise money through a public offering. Because of that, I was interested in helping other entrepreneurs obtain funds to start or expand their businesses, and Narragansett gave me that opportunity. We backed many start-up situations, usually with disastrous results. Some of the bright young men whom we financed proposed brilliant concepts, but too often they lacked administrative ability, and went broke. Narragansett, in fact, lost money on half of them. While a .500 batting average is super in baseball, it doesn't make stockholders in a venture-capital business very happy.

In the early Seventies, we decided to try a different approach. During the mid-Sixties the conglomerates had been gung ho for acquisitions, big and small, regardless of quality—so long as their own overpriced stock could be used to pay for acquisitions selling at lower price-earnings multiples. Using this technique, the conglomerates increased their own earnings per share every time they bought a company. Many managements thought that this procedure could be carried on forever. They learned later, however, that there is no such thing as perpetual motion, even in business. The conglomerates really ended up in the doghouse.

At Narragansett, we became convinced that the big diversified concerns would soon sell off many of their smaller divisions and concentrate on larger ones with growth potential. We knew that many of these smaller operations had excellent managements and good track records. To us, this looked like an opportunity to make safer investments than the start-up situations we had been putting our money into. So, since I was supposed to have been the "father of conglomerates," why shouldn't Narragansett start "deconglomerating the conglomerates"?

Since 1971, we have bought sixteen divisions or subsidiaries of diversified companies, and so far only two have been disappointments. The technique we use is popularly known as the "leveraged buy-out." Typically, we set up a new company that pays about eight times after-tax earnings, in cash, for the businesses we want to buy. In most cases, the purchase is financed in part by a five-year bank term loan, with a 50 percent balloon payment at maturity, and by ten-year subordinated debentures from Nar-

P 120 FORTUNE July 16, 1979 122,127
V.100

Burned by some venture-capital deals, Narragansett found happiness buying small divisions of big companies—and turning managers into owners.

he Conglomerates

by ROYAL LITTLE

ragansett, on which no principal payments have to be made until the sixth year. (The bank loans are usually made at about one and one-half points over prime; Narragansett charges 15 percent.)

These loans are piled up on the new company's balance sheet atop a tiny equity base: the debt-to-equity ratio has been as high as 14 to 1, and never less than 6 to 1. Narragansett puts up about half the equity capital, and the managers of the new company put up the rest.

Selling the managers half of the equity is the real key to success. Usually they are the same people who had been running the business before. Sometimes they have had to hock their homes and borrow against their life insurance to make the ante, so they work harder than ever to make a success of the company. The number of managers cut in has varied from one to as many as fifteen, but ideally, we like to have an equity contribution from everyone whose decisions could cause the company to lose money. That includes such people as the purchasing agent, the personnel director, and plant managers, in addition to the principal officers.

The Small Business Administration limits the size of the companies we can finance. The total number of employees is often the deciding factor, and the limit varies by industry, ranging from 250 to 1,500. We are also restricted as to the dollar amount we can invest in any one company; presently $2.7 million is our limit for total equity and debt. Consequently, all the companies we have acquired were pretty small—the purchase price was less than $10 million in every case, and often less than $5 million.

The businesses that interest us most are the "cash cows" buried in diversified companies. Divisions or subsidiaries that eat up cash—that need lots of capital or require heavy R. and D. expenditures—are better off under the conglomerates' wing. That includes most growth companies. We are happy to find companies with stable earnings. We know when we set up the new company that its profits will suffer once it gets socked with all the interest on the new debt load. But since the equity is so tiny, net worth builds up pretty fast, even with reduced profits. We always sit down before we buy and make a pro forma forecast, usually assuming that the company will continue to earn what it has in the past, less the interest. If we can see net worth quadrupling in less than five years and the cash flow servicing the debt amortization comfortably (and this isn't as hard to do as you might think), we are definitely interested.

Our very first deal of this sort was a big winner. In 1971 I had a call from Rudy Eberstadt, then president of Microdot, saying that his long-range plans involved concentrating the company's capital in three large divisions. He was looking to sell three small divisions, two of which were too large for Narragansett. The third one, however, was ideal, particularly since the management was interested in having a piece of the action. Varec, located near Los Angeles, made sophisticated equipment for keeping track, at a central location, of the contents of large containers such as those used in tank farms for storing gasoline and other liquids. The division had produced very stable earnings of more than $700,000 pretax for several years.

We set up a new company that paid $3.2 million for Varec, with only $500,000 of that in equity capital. The company grew fast, and in less than four years the managers decided the time had come for them to cash in their chips. In February of 1975, Varec stock was sold to Emerson Electric for $4.7 million, which gave the managers, and us, almost ten times what we had put up as equity.

At around the same time that we bought Varec, I had a call from Earl Fester, saying that his division of North American Rockwell, MD Pneumatics, was going to be sold. He had heard what Narragansett was doing, and thought we might be willing to finance him and other management people in buying the business. After checking out his operation, we decided to go ahead.

MD Pneumatics manufactures various types of industrial pumps and blowers and had shown a reasonable profit in the past. Its principal problem was that Rockwell had moved about a quarter of its equipment into another division, leaving MD with a huge, underutilized building. On the plus side, we felt that this gave MD the opportunity to expand its business without having to build new floor space. So we set up a *new* company that paid $2.6 million for MD in the spring of 1972. With the usual leverage, the equity investment was $400,000; fifteen management people put up half of it. Now, seven years later, the net worth is $2.5 million.

In 1973 I heard that Emerson Electric was considering the sale of its Greenville Tube Division, so I called Buck Persons, the business genius who built that company from $44 million in sales to over $1 billion before he retired as chairman in 1974. Emerson's management was indeed interested in disposing of the division. Persons was very high on

Eighty-three-year-old Roy Little, author of this article, gave up his title as chairman of the executive committee of Narragansett Capital Corp. in 1976, when his son, Arthur, thirty-five, became its chief executive. But the senior Little never learned how to retire, so, as the article attests, he stays active in Narragansett's affairs—without pay.

Photographs by [illegible]

When Bernard Buonanno (right) told Guy Little he wanted to leave his law practice, Little helped him buy into Old Fox Chemical Inc. The company had $[illegible] million in sales in 1970, the year Buonanno put up $[illegible] for [illegible] percent of the stock. Without investing another dime, he now owns [illegible] percent of Old Fox, which had $14 million in sales last year. "Guy," says Buonanno, "has been like an uncle to me."

Art McGonigal, the manager of Greenville, so we were enthusiastic about our plan to give Art an opportunity to become a substantial stockholder in the new company. Greenville was purchased for $4.8 million at the beginning of 1974. The managements of Narragansett and Greenville each put up half the $300,000 equity investment. By the end of 1976 the net worth had increased to $3.3 million, and later Greenville was transferred on an installment-sale basis to Bevis Industries, a company with an $11-million loss carry-forward, in which Narragansett had an interest.

In 1973 I discovered that Bendix was interested in selling its small fiber-optics division in Sturbridge, Massachusetts. Though the past earnings record had not been good, we felt that the long-range potential in this industry could be very great. So we paid the net worth of $3.3 million in cash, and put up, again on an equal split with management, only $300,000 of equity.

By the end of last year, net worth had built up to over $2 million. This operation could have the biggest long-range potential of any investment Narragansett has ever made. While fiber optics are now being put to work mainly in high-technology, low-volume applications in industry, the use of these materials will expand tremendously for the transmission of light and sound during the 1980's.

Three years ago, we made one of our most successful investments after my favorite business broker, Angus MacDonald, brought to our attention two divisions of Federal Signal—Burro Crane and Western-Cullen-Hayes. As it happened, Federal decided to hold on to Western-Cullen-Hayes for a while, but we negotiated a contract for the purchase of Burro, in the usual way, for $3.5 million. Equity this time was $400,000, 50 percent of which was put up by Narragansett and 50 percent by two able entrepreneurs who had not formerly been associated with the business. Burro is a leading manufacturer of on-track, self-propelled cranes for railroad right-of-way work. Its initial equity of $400,000 is now worth over $3.6 million on the books, and all of its original bank and Narragansett debt has been paid off.

MacDonald got in touch with us again in 1977, with the news that Federal was then willing to consider selling the Western-Cullen-Hayes division, which makes signaling, communications, and maintenance equipment for the railroad industry. The purchase price was set at $5.2 million, and the equity investment was the same as for Burro—$400,000. Already the net worth of this company is approximately $1.5 million.

Narragansett has been especially busy in the last couple of years. In 1977, we participated with Martin Block, president of Consolidated Food's Russell Taylor division, in buying that clothing business. Shortly afterward, I learned from Consolidated's chairman, John Bryan, while we were playing golf one day at Lyford Cay, that he was considering selling some more of the company's smaller divisions in order to concentrate capital in larger growth operations and develop cash for big acquisitions. The former managers of Consolidated had bought about seventy-five different companies in a ten-year period, so John had quite a few divisions available for possible sale.

John wanted to sell some of them as a package, so we finally worked out an unusual contract, under which Narragansett, with the backing of Industrial National Bank of Rhode Island, agreed to pay up to $33 million for six different divisions selling everything from hand tools to plastic bottles. We actually bought these businesses without inspecting the plants or meeting with management. Though the new companies seem to be doing just fine now, I doubt Narragansett will ever do such a thing again!

Our most recent transaction, closed in May, was another that came to us via Angus MacDonald. The business is U.S. Broach & Machine, a subsidiary of Quanex Corp. in Houston. In this case, Narragansett and a group of managers of Burro will each own half the stock. The president of U.S. Broach will have an unusual phantom stock plan plus other

Only one business has serious problems. I personally arranged its purchase, believe it or not, from Textron.

incentive compensation that will make his future compensation more attractive than it would have been had he remained the head of a Quanex subsidiary.

There were, as I said before, some disappointments along the way. One was Photo Systems, which operates photo labs and manufactures darkroom equipment for amateur photographers. It was a division of KMS, a Michigan conglomerate. As things turned out, Narragansett paid too much for it, and shortly after the new company was set up, our investment was in jeopardy. If Bill Considine, chairman of the executive committee of Narragansett, had not been willing to step in and troubleshoot, Narragansett would have lost its entire investment. Thanks to Bill's efforts, Photo Systems is on the road to health.

In all of the deconglomerating that Narragansett has financed, only one business appears to have any serious problems at the moment, and that is one we bought in 1973. It is currently in trouble because it is in a no-growth, overcapacity industry. The amazing thing is that I personally arranged this purchase, believe it or not, from Textron, and therefore can blame no one but myself for this mistake. I also selected the management to run it. The less said the better in this case.

On a couple of occasions, we have used the leveraging technique to give managers an opportunity to rearrange their personal financial situations. Often, when a manager is over sixty and his company has built up a substantial net worth, he wants to get some money out without going the dividend route and paying 70 percent in taxes. I once worked out an interesting way of making one of our older managers more liquid, without his having to give up ownership in the company he was running. We set up a new, highly leveraged company—call it Newco—to buy the assets of the existing company (Oldco) at tax-basis book value. Oldco then used some of the cash from the sale to buy out Narragansett and another shareholder, which left the manager in question the sole owner. Oldco held the rest of the cash from the sale, had no debt, and didn't even have any income-tax liability resulting from the transaction, since no profit was made. And since the manager didn't sell his shares, he personally paid no taxes.

Oldco used some of its cash to buy enough equity in Newco to leave the manager with nearly as much ownership in the new highly leveraged corporation as he had originally. (It took me two years to think that one up!)

When managers are younger and have no interest in cashing in their chips, they often try to get Narragansett to sell its stock back to the corporation. We did this in the case of Old Fox Chemical Inc.

One of my younger golfing friends, Bernie Buonanno, who was a lawyer in Providence, told me one day in 1970 that he would like to leave his practice and become active in the management of a business, provided he could purchase some of the equity of the company. Therefore, when the owners of Old Fox wished to sell, we paid them $2 million and set up a new, highly leveraged company to take over the operations. We permitted them to purchase 20 percent of the stock, provided they would stay on for three more years and train Bernie to take over the management. He put up $50,000 for 25 percent of the stock. Some other management people purchased 5 percent, and Narragansett got 50 percent. A couple of years ago Bernie suggested that Narragansett sell its stock back to Old Fox for nine times what we paid for it. We did so, taking a subordinated note in payment. Since then, Bernie has also had the company buy out the former owners. With his original investment of $50,000, he now owns 90 percent of Old Fox, which had sales of $14 million last year and has earned money every year of its existence.

One of the principal reasons Narragansett Capital has been so successful in deconglomerating the conglomerates was the wonderful relationship that Harvey Sarles, the former president of Narragansett, developed with Industrial National Bank of Rhode Island. This bank has been our principal backer, and at times has had over $70 million of loans and commitments outstanding with Narragansett portfolio companies. The bank seemed comfortable about going into these highly leveraged situations, since it was senior to Narragansett as a creditor and recognized that we wouldn't put our equity and debt capital into any business unless we thought there was a good chance it would be successful.

Although I have been credited (or, sometimes, blamed) with having originated the concept of conglomerates, I have now probably deconglomerated more conglomerates than anyone else. I am convinced after some sixty years of business experience that there are many types of small ventures that can be run to better advantage not only for the shareholders, but for the customers and employees, when they are independent operations and not just tiny fragments of a $2-billion or $3-billion conglomerate. One of the greatest satisfactions that I have had in life has been in offering opportunities to entrepreneurs to have a piece of the action, and, in many cases, to become millionaires. ■

APPENDIX KK.—FARMERS HOME ADMINISTRATION REPORT ON THE BUSINESS INDUSTRIAL LOAN PROGRAM

TABLE OF CONTENTS

I - INTRODUCTION

II - LEGISLATIVE BACKGROUND AND AUTHORITY

III - DESCRIPTION AND SCOPE OF THE B&I PROGRAM

- A. Description
- B. Congressional Limits
- C. Transfer of Capital
- D. Size of Communities Served
- E. Types of Businesses Served

IV - GROWTH OF THE B&I PROGRAM

- A. Number of Loans
- B. Employment
- C. Size of Loans
- D. Program Losses

V - ADMINISTRATIVE POLICY

- A. Loan approval and Criteria
- B. Goals and Aims
- C. Management Planning & Rural Development
- D. Close Monitoring

VI - AGENCY CONCERNS

VII - CONCLUSION

FARMERS HOME ADMINISTRATION

BUSINESS AND INDUSTRIAL LOAN PROGRAM REPORT

February 1, 1980

I. INTRODUCTION

This report is in response to the directive contained in the Conference Report accompanying H.R. 4387, "The Appropriations for Agriculture, Rural Development, and Related Agencies programs for fiscal year 1980" (Conference Report No. 96-553, P. 20 - 96th Congress, 1st Session). That report requires the Department of Agriculture "to conduct a full review of the scope, intent, and administration" of the Farmers Home Administration (FmHA) Business and Industrial loan program and to "report its findings, along with recommended administrative or legislative changes to the appropriate committees of Congress."

In this report, the agency provides the required information and outlines FmHA concerns of which the Committees should be aware.

II. LEGISLATIVE BACKGROUND AND AUTHORITY

The Farmers Home Administration's Business and Industrial (B&I) Loan Program evolved as a means of improving the social and economic quality of life in rural areas as expressed in Title IX, of the Agriculture Act of 1970:

> "The Congress commits itself to a sound balance between rural and urban America. The Congress considers this balance so essential to the peace, prosperity, and welfare of all our citizens that the highest priority must be given to the revitalization and development of rural areas."

Enactment of the Rural Development Act of 1972 (Section 310B) provided the Secretary of Agriculture the authority to establish the Business and Industrial loan program. (7 U.S.C. 1932 Rural Industrialization Assistance.) A key provision of this act reads:

> "Sec. 310B. (a) The Secretary may also make and insure loans to public, private, or cooperative organizations organized for profit or nonprofit, to Indian tribes on Federal and State reservations or other federally recognized Indian tribal groups, or to individuals for the purpose of improving, developing, or financing business, and industry, and employment and improving the economic and environmental climate in rural communities, including pollution abatement and control. Such loans, when originated, held, and serviced by other lenders, may be guaranteed by the Secretary under this section without regard to subsections (a) and (c) of section 333.

III. DESCRIPTION AND SCOPE OF THE B&I PROGRAM

The business and industrial program provides assistance to rural enterprises in the form of insured or guaranteed loans. At this time only guaranteed loans are being made.[1] FmHA may guarantee up to 90 percent of the principal on private, commercial loans made to any legal entity, including individuals, public and private organizations, and certain Indian tribes and others. The interest rate on each loan is negotiated between borrower and lender. In addition, the lender pays a one percent guarantee fee which may be passed on to the borrower. Repayment can be scheduled over a period of up to 30 years for land, buildings and permanent fixtures; up to 15 years for machinery or equipment; and up to 7 years for working capital.

Congressional Limits

Congress clearly recognized the need for flexibility in the administration of this program when it developed authorizing legislation. To assure that lending authority could be made to fit the varied needs of widely separated and diverse rural areas of the country, there is no statutory limitation on the kinds of loans to be made, or on the size of individual loans. However, the program is legislatively restricted to rural communities of less than 50,000 population, with primary emphasis on serving towns of 25,000 or less.

Transfer of Capital

The B&I program has sparked the beneficial transfer of major capital investment funds from large urban financial centers into rural communities. This has come about for a number of reasons. First, the guaranteed portion of the loans made by national banks do not count against the lender's loan limits. Second, local banks are able to sell off most of the loan to the secondary market. The result is that the smaller, rural banks, which normally deal in small, short-term loans, using only their own funds are able to attract investment capital from outside the community. This enables them to make larger, long-term loans with a minimum of risk and at a reasonable profit.

1/ FY 1980 budget limits availability of insured loans to $10 million.

Size of Communities Served

More than 74 percent of all projects receiving B&I loan guarantees since the beginning of the program have been located in communities with populations of less than 10,000. Towns or cities with fewer than 5,000 people were the sites of 53.8 percent of these projects, while 20.8 percent of the B&I projects were in towns of 5,000 - 10,000 population.

Projects in larger towns, of 10,000 - 25,000, have accounted for only 15 percent of all B&I loan guarantees; those in communities between 25,000 - 50,000 were only 10 percent of the total. The following table shows projects and funding by population.

B&I GUARANTEES BY POPULATION

Population	Number of Borrowers	Percent of Borrowers	Dollar Amount Obligated (000)	Percent of Dollar Amount
Under 5,000	2,209	53.5	1,476,978	46.4
5,000 - 9,999	856	20.7	622,587	19.6
10,000 - 24,999	634	15.3	652,439	19.2
25,000 & over	433	10.5	471,704	14.8

Types of Businesses Served

Loans are made to a broad range of businesses, including such diverse enterprises as shoe companies, fiber processing and textile plants, toy manufacturers, chemical and fertilizer manufacturers and retailers, commuter airlines, restaurants, grain elevators, farm machinery retailers, and many others. However, all of these businesses have at least two things in common: they create or preserve jobs in rural communities; and they bolster and undergird the local economy and tax structure where they are located.

The latter point is especially important. B&I-financed ventures are tax producers. With an enhanced tax base, community services and facilities can, to a greater extent, be locally-financed with less reliance on federal and state transfer funds, as is the case in economically-deprived communities. Thus in the long run, this loan guarantee program means less dependence on federal and state funds for the support of essential community facilities; water, sewerage treatment; schools, libraries etc.

Using the Standard Industrial Codes Classification, the borrowers listed for "manufacturing" comprise by far the largest group of any of the major eligible categories.

Of 4,132 loans obligated between 1974 and 1979, 1,428 were for manufacturing. These projects received about 51 percent of the total program allocation of $3.5 billion, and have accounted for more than 56 percent of the rural employment opportunities made available through the B&I program. The average number of employment opportunities per B&I project is about 70; the average loan guarantee amount expended per job is about $16,500.

The following chart indicates the distribution of loans among the 10 major standard Industrial Classification Codes.

Loans Obligated by Standard
Industrial Codes

TYPE OF BORROWER	NUMBER	PERCENT OF DOLLAR AMOUNT
Agriculture, Forestry and Fishing*	141	2.3
Mining	69	2.5
Construction	168	2.6
Manufacturing	1,428	51.7
Transportation, Communications Electric and Sanitary Services	275	4.9
Wholesale Trade	445	6.7
Retail Trade	720	6.9
Finance, Insurance and Real Estate	160	3.1
Services	725	19.2
Public Administration	1	0.1
TOTAL	4,132	100.0

*Note: By agency regulations, B&I loan guarantees may not be extended to entities engaged in agricultural production. The restriction is necessary to avoid duplicating FmHA's farm programs.

IV. GROWTH OF THE B&I PROGRAM

The first Congressional authorization for the B&I program was for $200 million in FY 1974 and provided authority to guarantee up to 90 percent of eligible, privately negotiated business and industrial loans in rural areas. From 1975 to 1977, the funds remained constant at $350 million. In 1978 when the program and need were firmly established, Congress expanded the program to the $1 billion level. In FY 1979 and 1980, Congress provided $1.1 billion. The budget request for 1981 is $1 billion. In 1979, change was made in the administration of present law so that only the guaranteed portion of an approved loan is applied against the appropriation.

The increased demand for B&I guaranteed loans is clearly revealed in the growth rate of loans obligated over the years. Also significant is the large number of loan applications pending in a pre-application status, or under review for feasibility or other conditions of eligibility.

FISCAL YEAR	NUMBER
1974	336
1975	481
1976 & T.Q.[1]	619
1977	548
1978	1,114
1979	1,507
Pending	782

[1] Transition Quarter - Fiscal 1976 was five quarters long.

Jobs

Employment opportunities are central to rural development and therefore are a major goal of the B&I program. Since 1974, over 145,072 new jobs have been created by this program; another 35,455 jobs have been saved in enterprises that likely would have gone out of business, for a total of 185,527 jobs directly created or saved.

Jobs Created or Saved	
1974	7,195
1975	18,820
1976	26,485
1977	17,852
1978	47,021
1979	63,154

The advantages of this additional employment in human terms and in terms of strengthening the tax base of rural communities are obvious. Less obvious are some of the secondary employment and economic benefits. But steady employment and improved income quickly translates into better housing, better nutrition, better health care and a generally improved standard of living. This upgraded life style leads to a broader tax base on which to build community facilities and provide needed public services for the community. Although the effect cannot be forecast or measured absolutely, the multiplier effect applies and a community more than doubles as it passes through the local economy.

Size of Loans

Since the program's inception, 58.8 percent of the B&I loan guarantees have been for amounts of $500,000 or less. Another 39 percent of the guarantees represented a range of loans between $500,000 and $5 million. The cumulative average size of outstanding B&I loan guarantees is $761,679.

FISCAL YEAR	AVERAGE LOAN SIZE
1974	$555,132
1975	$581,021
1976	$681,641
1977	$620,972
1978	$901,608
1979	$820,264

The overwhelming majority of loan guarantees made under the B&I program are geared to small and medium-sized businesses. A small business loan is defined as one requiring $500,000 or less of financing. A medium-size business requires between $500,000 and $5 million of financing. Over 97 percent of all business and industry borrowers have guarantees for loan amounts below $5 millions; 81 percent of the total were below $1 million.

best copy available

B&I LOANS

CLASSIFIED BY SIZE

LOAN SIZE	NUMBER BORROWERS	PERCENT OF BORROWERS	LOAN AMOUNT IN (000)	PERCENT OF AMOUNT
Under $100,000	707	17.0	$ 34,528	1.0
100,000 - 349,999	1258	30.3	251,944	7.5
350 - 499,999	477	11.5	193,072	5.8
500 - 999,889	943	22.7	673,662	20.2
1 - 1,999,999	416	10.0	544,965	16.3
2 - 2,999,999	160	3.8	378,191	11.3
3 - 4,999,999	104	2.5	378,387	11.3
5 - 9,999,999	61	1.5	397,647	11.9
10,000,000 and over	30	.7	489,356	14.7

Since 1974, FmHA has issued guarantees on loans to 91 borrowers for amounts over $5 million. This comprises just 2.2 percent of all loans involved and 26.6 percent of the dollar value of all loans. The following chart lists loans of over $5 million:

FISCAL YEAR	NUMBER	PERCENTAGE OF BORROWERS	DOLLARS (000)	PERCENTAGE OF ALLOCATION
1974	5	2.0%	57,674	36.4
1975	7	1.6%	86,250	28.2
1976	12	2.3%	117,250	31.7
1977	3	0.6%	22,267	6.4
1978	36	3.4%	298,426	30.2
1979	28	2.0%	305,136	26.1

In fiscal 1979, FmHA made its largest B & I loan, a $50 million guarantee to Wheeling-Pittsburgh Steel Corporation. This guarantee, combined with a $100 million loan from the Economic Development Administration and $10 million from the State of Pennsylvania, and about $40 million in private capital, is part of a national effort, authorized by Congress in the nineteen seventies, to help the domestic steel industry meet foreign competition; diversify; and to install mandated pollution abatement equipment. Without the Farmers Home loan guarantee, Wheeling-Pitt would not have been able to meet EPA regulations in its Pennsylvania, Ohio and West Virginia plants and would have had to close its doors with a resulting loss of 3,200 jobs.

Program Losses

The actual losses the agency has incurred in the first five years of business has been very low. For example, in FY 1976, the losses as a percentage of total loan amounts approved amounted to only 1.46 percent. The following table shows defaults as a percentage of total loan amounts approved. Normally, proven losses do not develop until a number of years after a loan is made.

1974	3.24%
1975	2.02%
1976	1.46%
1977	.15%
1978	.00%
1979	.00%

V. ADMINISTRATIVE POLICY

Loan Approval and Criteria

Applications for Business and Industry loans of up to $1 million are handled and approved on the state level. Ordinarily, preapplications for loans eligible for Small Business Administration (SBA) assistance (up to $500,000) are processed only after SBA has been given the opportunity to provide the requested assistance.

This does not preclude FmHA's assistance in areas where SBA may not be active or in cases where an applicant or lender specifically desires and asks for FmHA guarantee. This policy has been reinforced through a joint Memorandum of Understanding between the two agencies.

Requests in excess of $1 million are reviewed by the National Office prior to state office approval. In the case of requests for loans of over $5 million, preliminary project information is sent to Washington for review. This prescreening process enables the national office to evaluate the size of the loan, the availability of guarantee funds, and the priority of the loan's purpose. It permits FmHA to monitor requests for large loans in the field and eliminates some questionable and excessively large applications before a prospective borrower is encouraged to proceed further; thus in some cases saving the borrower and his financial institution time and money.

The agency is developing a policy to assure that many of the jobs created through the B&I program are available to the unemployed. Borrowers may be asked to submit a plan for hiring the unemployed, underemployed, or people in the Labor Department's CETA program.

Following are the major administrative criteria for consideration of all B&I applications, (not just larger ones, described earlier) listed in descending order of priority:

- Projects which will save existing jobs.
- Projects which will enlarge, extend or improve existing business or industry.
- Projects which will create the highest number of new jobs.
- Projects that contribute to the overall economic stability but do not necessarily generate a large number of permanent employment opportunities.
- Projects that alleviate pollution in rural areas.

These criteria are not all inclusive; other factors are also considered such as: how well the jobs pay the workers; how well the loan furthers national objectives as defined by various Presidential initiatives in transportation, energy, and other areas; how well the proposal meets existing state FmHA management plans; the economic health of the borrower including capitalization and operating performance if applicable; the preference to smaller towns and; the support of other federal, state and local agencies.

Business and Industrial loans are being used as an integral part of the White House Rural Initiatives described in detail in the Rural Development Progress Report of October, 1979 to foster, expand and improve the performance of governmental and private institutions in rural development. These initiatives provide focus, direction and priority to the myriad of separate Federal actions and policies involving rural health, housing, water and sewer, transportation, communications, and energy. They are being used separately and in tandem to build a more effective partnership among Federal, State and local governments and the private sector in meeting locally defined rural development priorities.

In addition to the White House initiatives, FmHA has initiated and participated in development of a series of memoranda of understanding with other federal agencies. The purpose of the memoranda is to cut through red tape by using a single form where possible to record and document federal assistance; to maintain constant interchange of information to avoid duplication of effort; and, when one agency cannot meet the applicant's entire need, to refer applicants for assistance to other agencies so that total available federal assistance may be "packaged" and programmed to meet that local need. Memoranda of understanding applicable to the B & I program include FmHA and these agencies-- Small Business Administration, Economic Development Administration, Department of Labor, Department of Housing and Urban Development, Department of Transportation, Office of Minority Business Enterprise and Community Services Administration.

Goals and Aims

The Farmers Home Administration is reemphasizing its policy of serving those people and communities most in need, and other important national objectives. In keeping with that general policy, the agency has set goals for B&I loans. Loan making priorities are reflected in these specific goals:

1) $50 million to depressed, high unemployment areas.
2) $100 million for alcohol fuel projects.
3) $50 million to revitalize small community downtown areas.
4) $50 million to women owned business.
5) $50 million to minority business.

Instructions and regulations are being prepared to carry out these aims.

Management Planning & Rural Development

The agency is completing the restructuring of its district offices throughout the country. District offices have been set up to coincide both physically and jurisdictionally as closely as possible with substate districts.

In some cases the state office has suballocated B&I funds by substate districts. This is an important management tool since it gives the District Director a better idea of the amount of funds he or she has to work with. The fact that a certain amount of federal funds may be available in an area should also stimulate local interest in development.

The restructuring of districts is expected to improve the rural development aspects of the B&I program. District Directors are working closely with other federal, state, and local planning groups to assure coordination and joint funding of development where there is no conflict with FmHA policies.

The suballocation of funds to the substate district level is expected to encourage smaller loan requests and to help insure a more equitable access to the program within each state.

In addition to restructuring, the states have developed state management plans which provide broad guidelines for the use of all FmHA program funds. Serving the areas most in need is an important part of the state management plans.

Close Monitoring

The agency maintains close monitoring of all B&I loans. Each application is entered into the Rural Community Facilities Tracking System (RCFTS) computer in Ft. Collins, Colorado. Information, including the number, type, size and geographic location of loans can be retrieved on short notice.

We are concerned that B&I guarantees are for quality loans that have a high probability of repayment on schedule. We are interested in helping local lenders tap new sources of money from outside the community through use of the secondary market; we are not interested in making guarantees merely to permit a local lender to make a questionable or high risk loan. And we are concerned that B&I loans provide a needed source of credit which does not compete with private lending, although the statutory authority does require a credit elsewhere test.

VI. AGENCY CONCERNS

The agency is concerned about the trend toward requests involving larger FmHA loans. Inflation accounts for only a part of that trend. Beyond that, rural communities are becoming more attractive to capital intensive industry. As industries expand, their credit needs become larger and more complex. The business and economic sector is becoming more and more aware of the FmHA guarantee program and each large loan invites similar requests from others.

For example, requests for loans have recently come from a major auto company and a large paper company. Other requests have come from a board manufacturing company for $25 million to manufacture a substitute for plywood; a railroad company for $20 to $25 million to purchase 800 miles of track; milk producers for $20 million to produce mozzarella cheese; an airline for $14 million; and a second steel corporation for $10 million to modernize a plant.

Several industries and whole sectors of the economic spectrum are now looking to B&I as a potential source of loan guarantees for new enterprises or for expansion of existing plants and services.

For example, transportation is among the most important components of rural development. It is absolutely essential to the economic stability of agriculture and many small towns and industries. Yet many major railroads are in or near bankruptcy. The capital requirements of the transporation industry can be substantial. We have received inquiries about FmHA assistance, which in some forms are beyond our capacity. However, at a more managable level, FmHA is guaranteeing loans to some small airlines and to groups formed to purchase and repair railroads spur lines.

The development of conventional and alternate energy sources is also vital to rural development. FmHA is receiving large numbers of applications for energy related loan guarantees, including solar, bio-mass, fuel-alcohol, coal, wind and low-head hydro projects of varied sizes and descriptions. Some of these proposals range from $15 to $50 million.

Secretary Bob Bergland announced on January 18 that FmHA has allocated $100 million of B&I funds for alcohol production this year. On February 6, Deputy Secretary Jim Williams, in testimony before the Senate Committee on Energy and Natural Resources, estimated that B&I loan guarantees could assist construction of distillation plants to produce about 25 percent of the 420 million gallons of additional fuel alcohol production capacity needed to meet President Carter's 1981 goal.

Alcohol, especially farm produced for local use, is a legitimate farm and small town rural development objective. FmHA strongly supports the funding of these enterprises.

FmHA has already received a heavy volume of applications for guarantees for gasohol facilities. We see no let-up in the volume of requests, or in the trend toward larger installations.

In writing the Rural Development Act of 1972, the Congress chose not to put a cap or ceiling on the size of loans or the size of business enterprise, nor did it attempt to define what is a large loan or a small loan. The legislative history of the Act seems to indicate that maximum administrative leeway should be reserved for Agency judgment in fitting B&I projects to the plans, needs, capabilities and desires of individual regions or rural communities.

This administrative flexibility has great advantages to the clients. But because it exists — and is lacking in many other federal loan and guarantee programs — the result is increasing pressure on limited B&I funds from prospective borrowers who — for whatever reason — have been unable to get help from other federal programs.

B&I restrictions are essentially two: Guarantees are limited to rural areas and loans to agricultural producers are prohibited. This is in sharp contrast to many other federal programs. Some such as Small Business Administration, have a "cap" on their loan amounts. Others are sharply limited to categorial assistance such as to certain airlines or airline facilities, to railroads, etc. Other regulations or statutory limitations forbid such things as refinancing or some other essential credit element which may be necessary to the continued existence of a job-producing rural industry. Other agencies, such as EDA, are limited to loans in certain counties.

Because, either by statute or regulation, these other programs cannot provide a "lead" agency role in their categorial area, such as transportation, (as an example) borrowers either are sent to FmHA by other federal lenders or discover the program for themselves, with steadily increasing pressure on limited funds.

VII CONCLUSION

As stated earlier, FmHA's administrative approach is changing as its rural development role is expanded. The agency is closely watching the size of loans and working with other federal, state and local agencies to maintain a balance between the size of loans, jobs, and the need for regional economic development. When possible, other public and private agencies participate in loans.

The competence of FmHA loan specialists, their location in rural areas and their knowledge of local financial practice - as well as their knowledge of rural development planning — put the agency in a unique position to carry out the mandates of the nation's rural development policies. This permanent location of the loan offices in the geographical area they service has additional benefits to the government and to the local community: Loan officers are here on a continuing basis and accountable to the people, businesses and communities they service. They are also physically present in the project area to monitor the loan to insure that it purposes are being carried out.

It should be noted that these policies must be flexible and innovative because of the rapidly-changing dynamics of rural America. As the Senate Appropriations Committee pointed out in its July 12, 1979 report:

> In trying to take a strategic view of the future of (FmHA) it is necessary to examine the trend of changes in rural America. From 1960 to 1970, about 1,225, or almost one-half, of the nonmetropolitan counties declined in population. But, from 1970 to 1977, only 525 declined and about 700 had net increases in population. The rate of growth in these counties has exceeded that of metropolitan counties since 1970. Even when viewed against a backdrop of increasing energy costs, these movements seem to be the long-term trend.

FmHA has undertaken a number of administrative actions in its management of the B&I program to meet the changing challenges and to improve service. Following discussions involving the agency, the Deputy Secretary, and the Assistant Secretary for Rural Development, the following B&I administrative and regulation changes have been made and are currently being evaluated:

1. An internal review function has been established for the purpose of conducting on-site evaluations of state B&I programs. From the reviews, program accomplishment can be better evaluated and further administrative or training needs can be determined.
2. B&I staff will now meet on an annual basis with each lender to evaluate loan and lender performance.

3. We are now negotiating the percentage of loan guarantee offered. Loans with more relative risk potential will be offered a lower percentage guarantee if the project still appears viable, to more equitably share the risk between lender and government. This practice will serve to lessen program losses and simultaneously allow us to guarantee more projects.
4. Preapplications and applications will not be accepted unless a lender has been identified who will fund the project. This serves to concentrate our resources on legitimate proposals.
5. Standards have been determined and made available to field personnel which will require more active involvement of Office of General Counsel in providing legal advice for loan making and liquidation situations.
6. Credit reporting services have been improved to provide us with notification of significant changes in loan status and the automation of financial trend analyses.
7. Our definition of local lender has been modified to require more emphasis upon lender capability than upon lender location.
8. A borrower can no longer buy a participation in its own loan.
9. The concept of shared-risk has been introduced. As a result, a lender is required to retain at least five (5) percent of the loan. We believe this will force lenders to perform more responsibly in loan administration and will preclude small lenders from sponsoring very large projects which they are not capable of servicing.
10. We have defined what is reasonable to us on the subject of loan fees and related charges. This is meant to prevent unreasonable lender yields which tend to encourage lender laxity when responsible loan servicing is needed.

11. Requests in excess of $5 million are pre-screened to determine how well they meet program objectives and whether loan authorities might be available. This process allows us to control the development of large projects in their earliest stages. Also, it precludes incurrence of unnecessary time and expense to all parties from developing projects that we ultimately cannot approve.

12. Our definition of equity has been strengthened to require more equity contribution for higher risk or new businesses and elimination of intangibles and appraised values in equity composition.

13. We have restricted debt refinancing to those projects that remain viable and whose continuation is vital to the locality. If the same lender is refinanced, the percentage of guarantee is reduced to retain lender exposure the same as it had been.

14. Personal and corporate guarantees will be secured by personal assets when project collateral or risk, in judgment, requires.

The Farmers Home Administration does not believe there is a need for legislative changes at this time. However, we invite and encourage the interest and guidance of Congress as we develop administrative policies.

Because of the Business and Industry guarantee loan program, rural areas are able to tap capital investment funds which formerly were only available in the major money markets of urban America. The availability of employment and broadened tax base resulting from the program is strengthening the general economy of rural areas. The secondary effects of the Business and Industry program are shoring up existing enterprises and creating an atmosphere of progress toward an improved standard of living for people throughout the rural areas of the nation.

In conclusion, we feel that the agency is accomplishing its task and is capable of reaching the high standards and goals entrusted to it by Congress.

APPENDIX LL.—MATERIAL SUBMITTED BY HON. LAWRENCE COUGHLIN: ARTICLES FROM THE PHILADELPHIA BULLETIN

LAWRENCE COUGHLIN
12TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
APPROPRIATIONS

RANKING MINORITY MEMBER
SUBCOMMITTEE ON
HUD-INDEPENDENT AGENCIES

MEMBER
SUBCOMMITTEE ON
TRANSPORTATION

Congress of the United States
House of Representatives
Washington, D.C. 20515

WASHINGTON OFFICE:
[illegible] CANNON BUILDING
(202) 225-6111

DISTRICT OFFICE:
700 ONE MONTGOMERY PLAZA
NORRISTOWN, PENNSYLVANIA 19401
(215) 277-4040
896-1765

April 9, 1980

Honorable Berkley Bedell
Chairman
Subcommittee on Antitrust and Restraint
of Trade Activities
Committee on Small Business
B-363 Rayburn Building
Washington, D. C. 20515

Dear Mr. Chairman:

I understand that the Small Business Subcommittee on Antitrust is conducting a study of conglomerate mergers and their effects on local communities.

In Philadelphia and suburbs, a considerable amount of merger-related activities has taken place. Some mergers have reulted in substantial inpact on the community.

The Bulletin, a major metropolitian daily newspaper, took a close look at mergers and their effects in the Philadelphia area in a three-part series of articles. Enclosed are copies of the articles which I believe are germane to your deliberations. I request that they be included in the Subcommittee's records.

With all best wishes.

Cordially,

Larry

LAWRENCE COUGHLIN

LC:th
Enclosures

The Bulletin March 10, '80

Phila. loses status, as well as jobs, in mergers

By JANET NOVACK
Of The Bulletin Staff

In 1973, they were on top. The biggest and presumably most powerful companies based in Greater Philadelphia. The ones *Focus Magazine*, a local business publication, chose to christen the Focus 50.

Whatever happened to the class of 1973?

As a group, they have had enough trials, traumas and marriages to sustain a soap opera, with maybe a few spinoffs to boot.

One is in the process of liquidating. Four have moved to other climes. Five have had dealings of some sort with the U.S. bankruptcy court. And nine — or 18 percent — have been taken over by other companies.

I-T-E Imperial Corp., ESB Inc., American Medicorp, they are just a few of the companies that have been taken over and have taken down their name signs.

As members of that first Focus 50 have fallen, other companies have moved up into the group. Some of them have been swallowed up, too, caught in the undertow of what Alfred F. Dougherty Jr., director of the Federal Trade Commission's Bureau of Competition, calls "a continuing merger wave."

Of the 50 companies on the Focus 50 list for 1979, four have already been, or are in the process of being acquired. A fifth just last week fended off what it considered to be a takeover attempt.

Smaller companies are being snapped up in even greater numbers.

"It has become acceptable," Harold M. Williams, chairman of the Securities and Exchange Commission told a House subcommittee last month, "to assume that corporate control may change hands with no greater concern about the consequences than accompanies an exchange of property deeds in a game of Monopoly." But in real life, Williams added, there are more than two players in on each deal.

"Employees, suppliers, customers, communities, the economy and the polity at large," all have a legitimate interest in the fortunes of a corporation, he said.

• • •

Joseph Ferrara, district director of the United Auto Workers, did not sound like a happy man. His union was about to vote on a contract to "salvage" 1,600 jobs with Gould Inc.; but another 400 to 500 jobs were being lost — to a plant in South Carolina.

Marriage, corporate style

The country is in the midst of a merger wave and the Greater Philadelphia area is caught in the undertow. In a three-part series beginning today, The Bulletin examines how corporate takeovers may be affecting this area.

In addition, the three-year contract, which members of Local 1612 approved by a vote of 987 to 440, called for no wage increases in the first year and 3-percent pay boosts during each of the following two years.

Had Gould been pushed any farther, maintained Frank Redmiller, president of UAW Local 1612, the company would taken all its jobs and fled the area.

The workers would not be having such a rough time, Ferrara insisted, if they were still working for I-T-E Imperial Corp. But I-T-E was taken over by Gould in 1976, and it had been, from his view, trouble ever since. At one point, Gould had actually started dismantling its manufacturing equipment at two Philadelphia plants and shipping it south. Gould later brought the equipment back to comply with a labor arbiter's ruling.

Mergers "hurt the workers," Ferrara declared.

Traditionally, many economists have viewed mergers as a positive thing, figuring those companies which were taken over were short on capital or management.

Takeovers, their admirers say, also allow entrepreneurs who have built up a business to convert their sweat into hard cash. And they produce tidy gains for stockholders of publicly owned companies.

But some merger doubters take a different view. They say many of the companies being picked for mergers are ripe plums, not lemons. Those companies, they say, might fare better and live longer on their own.

Sometimes, says Norman Glickman, an associate professor of city planning at the University of Pennsylvania, a corporate acquirer will "buy out a company that has a lot of money and conservative management" and use it as a "cash cow," milking its profits and investing them elsewhere, rather than putting them back into the plant.

The economy would be better off, the critics say, if the big companies would use their cash to start up new ventures not buy them. And communities, they say, would be better off if they could keep greater local control of their businesses.

Henry Wendt, president of Philadelphia-based SmithKline Corp., which has done some big-time acquiring of its own lately, expresses a fairly typical big businessman's view.

"Over the long term I believe very strongly that it (the takeover process) is a normal part of life. But as far as Philadelphia is concerned, it's not favorable to Philadelphia."

Henry Wendt, president of SmithKline Corp.

"It has become acceptable to assume that corporate control may change hands with no greater concern about the consequences than accompanies an exchange of property deeds in a game of Monopoly."

Harold M. Williams, chairman of the Securities and Exchange Commission

"Lots of cities that had an autonomous life of their own, like Philadelphia are ceasing to be headquarters cities and decisions about their economic fate are being made by absentee owners."

William Gomberg, Wharton professor of management and industrial relations

Cities ranked by number of manufacturing company headquarters*

City	Number of headquarters
New York	81
Chicago	24
Pittsburgh	15
Los Angeles	12
St. Louis	12
Stamford, Conn	12
Cleveland	11
Houston	11
(8-County Phila. area)	11
Dallas	9
Minneapolis	8
Milwaukee	7
Toledo	7
Greenwich	6
PHILADELPHIA	6
San Francisco	6

*Based on Fortune Magazine's list of 500 largest U.S. industrial companies.

Please Turn to Page 16

Phila. loses status and jobs as mergers swallow firms

Continued From Page [illegible]

Says he: "Over the long term, I believe very strongly that it (the takeover process) is a normal part of life. But as far as Philadelphia is concerned, it's not favorable to Philadelphia."

"I think Philadelphia is losing more than we're getting," in the takeover process, agrees Walter Arader, chairman of the Pennsylvania Securities Commission and a professional merger maker.

"It is the general feeling," says Walter D'Alessio, executive director of the Philadelphia Industrial Development Corp., "that Philadelphia, which is primarily a city of small family-owned businesses, suffers a lot more from acquisitions than cities that are characterized by larger businesses."

"Absentee ownership is less inclined to keep things open," worries Philadelphia City Representative Richard A. Doran. But, he adds, the city gains from takeovers too.

Questions about the effects of takeovers seem particularly loaded now that some politicians are pushing legislation that would put new restraints on mergers. And in Philadelphia, such questions have a special sting. For one thing, the hemorrhaging of jobs — the city itself lost 131,000 jobs during the past decade — has heightened sensibilities to anything that might cost jobs.

For another, Philadelphia's standing as a home base for major corporations — the ones doing much of the acquiring — has been slipping.

"Lots of cities that had an autonomous life of their own, like Philadelphia, are ceasing to be headquarters cities, and decisions about their economic fate are being made by absentee owners," observes William Gomberg, a Wharton School professor of management and industrial relations.

Back in 1967, a study done by an economist at the Federal Reserve Bank of Philadelphia found that the eight-county Philadelphia-southern New Jersey region ranked No. 3, behind New York and Chicago, as a home for major headquarters. When just industrial companies were considered, it came in fourth, behind Pittsburgh.

Major corporations were defined by the economist as those on *Fortune* magazine's list of the 750 largest companies — the top 500 industrials plus 50 each in five nonmanufacturing categories. The Philadelphia area had 28 of them, down from 35 a decade before, she found.

A survey of the most recent Fortune 500 list shows that the eight-county Philadelphia area is tied with Cleveland and Houston for seventh place as a headquarters for the big industrial fish. Los Angeles, St. Louis and Stamford, Conn., have moved ahead. When just the City of Philadelphia is considered, it is tied for 13th place with Greenwich, Conn., and San Francisco, and behind Dallas, Minneapolis, Milwaukee and Toledo.

As for the current top 750 corporations, the eight-county Philadelphia area now plays host to 18 of them, which ties it for fifth with Pittsburgh and Minneapolis. Los Angeles and Houston have moved ahead. And Philadelphia itself only has 12, which puts it well behind Cleveland, St. Louis, and Dallas.

Some of the attrition of Philadelphia-based corporations is due to migration, some to business misfortune — and a good deal to mergers.

Tomorrow: White-collar workers face the music first.

White-collar jobs often first to go after merger

By JANET NOVACK
Of The Bulletin Staff

3-11-80

When a local enterprise is taken over, white-collar workers are the first to face the music. Sometimes, it's a dirge.

Companies rarely pack up a newly acquired plant and ship it off, lock, stock and barrel. But paper and paper pushers are another matter. The paper is portable. And after a merger, the incumbent paper pushers are sometimes expendable.

"When the parent company is in the same business, there is more often than not, overlap between the two companies," observes Barton H. Lippincott, president of J.B. Lippincott Co.

Lippincott, since being acquired by Harper & Row last September, has pruned its payroll by about 20 workers.

Had the company remained independent, he says, it would have had to take similar "doses of Metrecal" to survive.

Examples of either headquarter personnel of an acquired company losing out or the headquarters itself moving out, aren't hard to come by.

— In September 1977, Gulf Oil Corp. acquired Kewanee Industries Inc., a diversified oil, gas and industrial-chemical company headquartered in Bryn Mawr, Pa. Gulf "folded" Kewanee's oil and gas holdings into two of its own divisions and has sold Kewanee's brick headquarters near Bryn Mawr railroad station, a Gulf spokesman said. There is no remnant of Kewanee left in Philadelphia.

— In April 1978, AID Inc., a Rosemont, Pa.-based operator of health-care facilities, was acquired by Philadelphia's own INA Corp. INA, reports a spokeswoman, merged AID into its Nashville, Tenn.-based Hospital Affiliates International Inc. subsidiary, eliminating the AID headquarters in this area.

— In January 1978, after a 3½-month battle, Bala Cynwyd-based American Medicorp Inc. finally agreed to be acquired by Humana Inc. of Louisville. In September 1978, after all the details of the merger were complete, Humana closed American Medicorp's offices here, a Humana spokesman says.

Marriage, corporate style

The country is in the midst of a merger wave and the Philadelphia area is caught in the undertow. In the second part of three articles, The Bulletin examines how corporate takeovers may be affecting this area.

Few top management personnel transferred to Louisville, he notes. "There was such a difference in management philosophy it was understood most would go," says H. Taylor Vaden, who was director of community relations for Medicorp and now works for the University of Pennsylvania.

The actual number of jobs involved in most headquarters operations will not make or break the Philadelphia-area economy. Medicorp's headquarters, for example, employed about 200 people before the acquisition, AID's about 35.

So what's the big deal?

The loss of headquarters, insists Alan B. Miller, president of Medicorp until Sept. 6, 1978, "has a domino effect on the city."

It wasn't just 200 jobs that were lost by Medicorp's demise, he says. "The accounting firm lost the business. We had legal (firm) bills. We had travel (agency) bills. We'd go to lunch. We'd go to dinner. We'd have people visiting us, so we used hotels. We paid taxes. Everybody loses."

It is not just when a takeover results in a move that local accounting, legal and advertising firms lose out.

Earlier this year, Kellogg Co., which acquired Pottstown-based Mrs. Smith's Pie Co. in 1976, announced it was transferring more than half of the Mrs. Smith's advertising billings from a Philadelphia to a Chicago ad agency because it wanted to consolidate there its promotions for frozen dessert pies.

Then there is the matter of civic involvement. Executives play a role in raising money for charities and the arts and in promoting the city. A corporation's headquarters city "gets the lion's share of attention" when it comes to such activities, says Henry Wendt, president of SmithKline Corp.

Please Turn to Page 16

White-collar workers usually first to go after a merger

Continued from Page 11

After Gould Inc. took over I-T-E Imperial Corp., Gould executives withdrew from the corporate partnership developing Franklin Town, Mayor notes.

Local businessmen gripe the outsiders don't want to get involved, too, says Philadelphia City Representative Richard A. Doran. "I find that too often they were not invited in."

Losses in production rarely follow a merger immediately. And when the acquiring company does shut a plant, it usually argues that it is old and inefficient. Sometimes the companies maintain that their resources actually gave the plant extra years of life.

— In 1977, ITT-Nesbitt Corp., which had manufactured heating and air-conditioning systems at State road and Rhawn st. for more than 50 years, moved its operations to Jackson, Tenn. It cost the area 250 jobs. At the time, Walter D'Alessio, executive director of the Philadelphia Industrial Development Corp., was moved to suggest that Congress enact penalties against multinationals that shift operations. Nesbitt Co., an independent Philadelphia company for more than 50 years, was acquired by ITT in 1963.

— In Jan. 1979, Electric Storage Battery moved production of its Northeast Philadelphia Exide Battery division to plants it owned in the South, at a cost of about 250 jobs. ESB was acquired by Inco. Ltd., a Canadian company, in 1974. As of Jan. 21, there is no more ESB. It is now called Inco ElectroEnergy Corp. But a spokeswoman cites the nearly 400 white-collar workers still toiling away for the company in center-city Philadelphia as evidence of its commitment to the area.

— In 1953, White Motor Corp. took over Ardmore-based Autocar, promising to give it a new lease on life. In fact, White Motor did just that, building a new $2-million plant in Exton. But last week, the last trucks rolled off the Exton assembly line and White transferred Autocar production to Ogden, Utah, putting 650 employes out of work.

"What we've learned in the past," says James C. O'Brien, manager of area development for Philadelphia Electric Co. is that after a company is bought, "it doesn't seem too long before they pull up stakes and move somewhere."

The matter, however, isn't simple. Companies don't just pick up a Northeast plant one day and move it to the South the next, recent studies suggest. Harvard Professors Robert A. Leone and John R. Meyer, writing in *The Wharton Quarterly*, say they've found such long-distance moves are rare and are almost always shifts by single plant operations, not big companies.

But across town, two economists — Bennett Harrison of the Massachusetts Institute of Technolgy and Barry Bluestone of Boston College — take a different tact. They agree that companies don't move overnight. But there are other, "more subtle" ways owners move their capital, they say.

They charge conglomerates in particular are guilty of treating one plant as a "cash cow" and "milking" it for another. Eventually, the cow gets milked out. It is no longer profitable — or profitable enough — to meet the conglomerate's standards. So it's put to sleep.

Of course plants close every day. It's a normal part of life.

David L. Birch, director of M.I.T's program on Neighborhood and Regional Change, fed information about 5.6-million business establishments into a computer and found that each year 8 percent of all jobs die; that number holds in booming Sunbelt and sagging Northeast alike. What is different is how fast new jobs are created in those regions.

From 1969-76, Birch found, small business generated "all net new jobs in the Northeast" compared with only about 54 percent in the South and 60 percent in the West.

"The larger corporations," Birch concluded "are the first to redistribute their operations out of declining areas into growing ones . . . placing an even greater burden on the smaller firms in struggling areas like the Northeast."

Mergers can, of course, give Philadelphia a pipeline to new jobs, too.

FMC, a Chicago-based conglomerate that has three operating groups based in Philadelphia, is frequently cited as a prime example of that.

In 1963, FMC acquired American Viscose Co. In 1975, when FMC was looking for a place to consolidate its industrial chemicals group, two of the four divisions, previously part of American Viscose, were already here.

One of the others was in New York; one in Middleport, N.Y. New York City and Buffalo were both con sidered, but the former was deem "too expensive" and the la "didn't ring anybody's bell," sa William A. McMinn, vice presid and general manager of the indu al chemicals group of FMC Corp. . Philadelphia won out.

FMC now employs 900 people downtown Philadelphia. It has so one of American Viscose's divisi and closed the Marcus Hook plant the other, eliminating about 600 jo

But Philadelphia remains FMC largest corporate base outside C cago.

3-12-80

Why merge? Why not, the money's so good

By JANET NOVACK
Of The Bulletin Staff

Marriage, Corporate Style

The country is in the midst of a merger wave, and Greater Philadelphia is caught in the undertow. In the last of a three-part series, The Bulletin examines why so many mergers are taking place.

"My wife is for sale at the right price."
— Bernard Kast, chairman of Silo, Inc.

So maybe those aren't immortal words. Shakespeare's reputation is intact.

But Kast's little declaration, made just weeks before Silo announced it had agreed to merge with Cyclops Inc., is worth remembering nonetheless.

Because it says a lot about why so many firms — some of them perfectly happy and healthy on their own — are being sold nowadays. The price — the premium being offered above a stock's market price — is right. In Silo's case, it was a $24-a-share offer for stock that within the year before had sold for as low as $10.25.

More and more corporations are making other corporations offers they can't refuse. Executives who turn down such lucrative bids risk incurring the wrath and lawsuits of those stockholders who would just as soon take their capital gains and run.

With stocks low and inflation high, the experts say, corporations find it more attractive to buy a going concern — even at a fat premium over its stock market price — than to build a new business from scratch.

They may not want to increase their investment in their existing lines of business because of low rates of return, government regulations they consider burdensome, or because those businesses are particularly vulnerable to the ups and downs of the economic cycle. In addition, many businessmen claim, the threat of legislation which would curve some conglomerate mergers has created a "buy now before it's too late" rush.

Then there's the growth mystique.

"The immediate results of a takeover," Securities and Exchange Commission Chairman Harold M. Williams told a House subcommittee last month, "are particularly attractive to a corporate executive who seeks the satisfaction, prestige and remuneration associated with size and at least the appearance of growth." Investment in new projects, he said, takes longer to pay off and may not fit some manager's "short-term horizon in office."

Corporate weddings are getting bigger these days. In 1978, according to the Federal Trade Commission, 2,106 acquisitions, worth about $34.2 billion were announced. Last year, the number of acquisitions increased only slightly. But their value was up 27 percent over the year before, to $43.5 billion.

And shotgun marriages are all the vogue.

"The first, and perhaps most unsettling, aspect of the current wave of mergers and acquisitions is the legitimacy which hostile tender offers

Please Turn to Page 13

Why merge? The money's so good

Continued From Page 11

have come to enjoy," Williams told the House subcommittee.

William E. Chatlos, a principal of Georgeson & Co., a public relations firm specializing in investor relations, has made a study of such things.

Once someone makes a cash tender offer for a company, he says, there is a "90 to 95 percent chance that that victim company will die at somebody's hands in the near future." Chatlos calls that the "kill rate."

Benjamin Fox, chairman and founder of Elco Corp., now a unit of Gulf & Western, offers one clue as to why the "kill rate" is so high. Elco, which had been based in Willow Grove, agreed to merge with G&W after fending off two other unsolicited takeover bids.

"Every time a tender offer came through, it cost a quarter of a million dollars," to fight and monopolized management's time, Fox recalls. He chose to hook up with G&W because he had "great respect" for the outfit and didn't want his company "to fall into the hands of a tender offer," Fox says.

The Philadelphia area has seen lots of examples of public companies of all sizes fending off an unwanted offer and finally falling to one of several suitors, usually after winning extra spoils for shareholders.

"Philadelphia has kind of gotten that image as a place to look for an undiscovered company that's doing well," and is worth acquiring, says Theodore J. Swift, public relations director of Leeds & Northrup Co. But Philadelphia companies, he added, "don't give up easily. I-T-E (Imperial Corp.), ESB (Inc.) and we went down flags flying, (but) ours had less blood on it."

In 1976, Tyco Laboratories began buying stock in Noth Wales, Pa.-based Leeds & Northrup. "In the beginning, we were advised by a Wall Street banker we had 30 days, and we ought to fo find ourselves a white knight," recalls Swift.

The offers poured in. "There were in excess of 100 companies that approached Leeds & Northrup at one stage or another . . . from the ridiculous to the sublime," says Swift. "At first," he recalls, "we believed we could go through the courts, remain independent . . . Later on, it became a matter of finding the best deal for the shareholder."

Leeds & Northrup's managers were also interested in preserving the company's identity and, presumably, their own jobs. They eventually hooked up with Stamford, Conn.-based General Signal Corp., a company which Swift says had a reputation for allowing its subsidiaries to retain their identity. "To see another Philadelphia-headquartered company just evaporate was not for us . . . we'll always be Leeds & Northrup," he says.

Lots of takeovers, of course, are completely voluntary and happy affairs.

The acquisition of West Chester-based Gagliardi Brothers Inc. by H.J. Heinz Co. for $39 million last month is one example of that. Eugenio Gagliardi Sr., founder of the company, has big plans for his company and its most popular product — Steak-Umms.

Assessing the economic impact of takeovers. Unfortunately, the answers aren't simple.

"It's like snowflakes. No two acquisitions are the same," Walter D'Alessio, executive director of the Philadelphia Industrial Development Corp. says.

A traditional view is that these corporations that are taken over are deficient in some way — lacking in management skill or capital. For example, University of Chicago economist Yale Brozen told the House subcommittee that a study showed acquiring companies have been a boon to stockholders of "poorly managed (acquired) firms," who were getting a below average return on their investment before the acquisition.

That study just covered companies listed on the New York Stock Exchange. And Chatlos, for one, argues that the fact that a stock has sagged on the market doesn't mean it isn't worth more or well managed. Then there is recent research suggesting that only certain types of companies benefit — when compared to comparable independent companies — from takeovers.

• • •

Talk to executives who work for firms that have been players in the acquisition game, and a Jekyll-and-Hyde view of mergers tends to emerge.

Not surprisingly, executives who have held on to their jobs after the merger often think they were part of a "good" merger, which, they say, helped, or at least didn't hurt, this area.

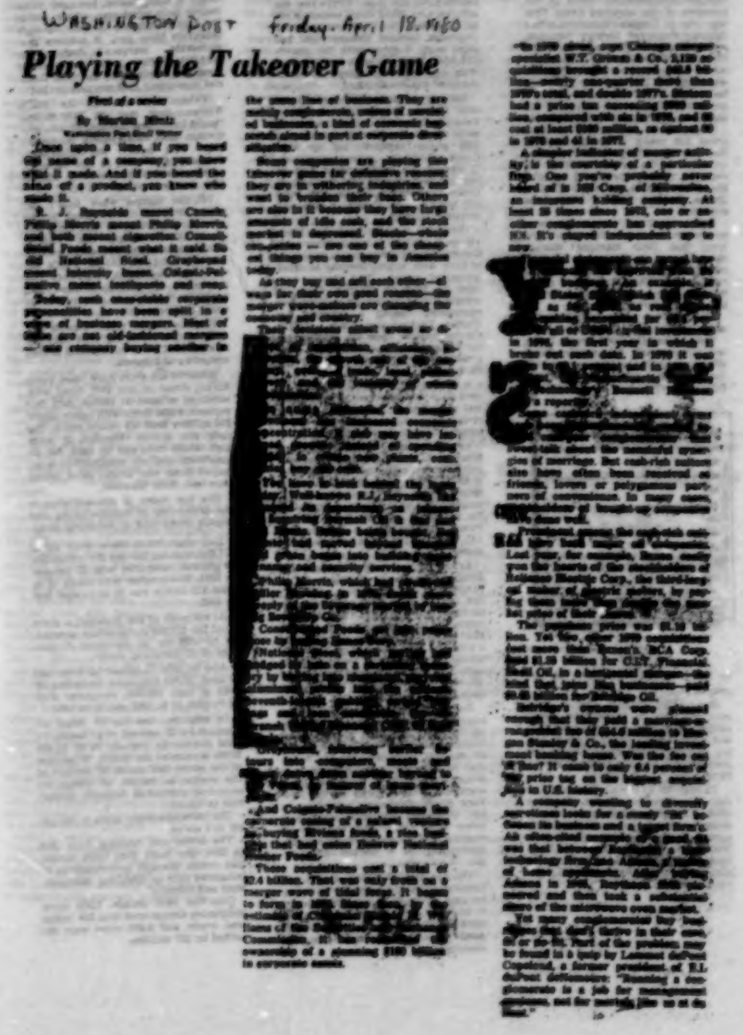
When the Glenmede Trust Co., which represents several Pew family charitable trusts, decided to sell its 43-percent stake in Radnor, Pa.-based Chilton Co., "there were a lot of people who looked at us, 30 companies over two years," says William A. Barbour, president of Chil-

merger, and "the scuttlebutt is things are starting to change," he says.

Does Barbour foresee a day when Chilton would be moved from Radnor?

"Wash your mouth out," the executive responds.

APPENDIX MM.—WASHINGTON POST SERIES ON CONGLOMERATE MERGERS



WASHINGTON POST Friday. April 18. 1980

Playing the Takeover Game

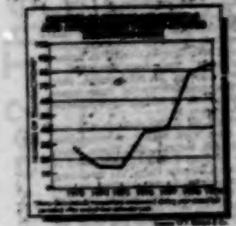
In other cases, conglomerates have sold back acquisitions to buyers, including—occasionally—heirs of the founders of the acquired firms. This was true of Colgate-Palmolive, which recently disgorged Hebrew National, [illegible] of Riviana Foods and Hart Ski. Founded in World War II by three high school dropouts, Hart Ski was bought in 1965 by Beatrice, which lost money on it; was sold in 1977 to a group including a son of one of the founders and began to prosper anew.

Acquisitions may make perfect sense for many firms—particularly those too big to be gobbled up by anyone else. In the period 1972-1978, for example, none of the top 50 industrials—firms such as the Exxon oil company, General Motors, IBM—was acquired.

For many likely targets, however, acquisition is such a repugnant prospect that their managers devote their central attention to developing elaborate defensive strategies, such as retaining a "White Knight" to gallop to the rescue by acquiring control of the target before a raider can.

The takeover game has become a managerial preoccupation. It has to be.

Even among the 1,000 largest industrial firms, nearly 400 consider themselves vulnerable to takeover, and 400 have developed formal defensive strategies, according to a late 1979 survey by the National Association of Accountants.



The Washington Post

Some firms have resisted takeover attempts by hitting the deck, calling the regulatory cops at the SEC and state capitals, going to court, hiring private investigators to dig for scandal, and summoning [illegible] lawyers.

To stay out of the clutches of financier Victor Posner (Sharon Steel) in 1978, Foremost-McKesson (foods, drugs, liquors) got an injunction against further purchases of its stock. When the injunction ran out, Foremost was ready with a contingency plan to be bought up by friendly private investors.

In 1978, Occidental Petroleum made a bid, ultimately unsuccessful, for Mead Corp. Launching a swift counteroffensive, the paper firm's two top officials sent Mead share owners a letter recalling that Occidental and its chairman, Armand Hammer, had had some early brushes with the securities laws. Phrases such as "criminal violations" and "repeated course of conduct" were underlined.

Some firms contrive to make a takeover illegal. Daylin Inc. (women's wear, health foods, home improvement items) did that in defeating a $120 million takeover bid by W.R. Grace (chemicals, natural resources). It offered $80 million for a firm in some of the same lines of business as Grace, thus making Grace—if it actually were to buy Daylin—a potential antitrust violator.

Other firms, suspecting that their allure is mainly in their large cash deposits, spend them on acquisitions of their own, hoping thereby to repel unwanted suitors. This device was used in 1978 by Carrier Corp., a maker of heating and air conditioning equipment. Facing a takeover by United Technologies Corp. (UTC), Carrier bought Jenn-Air (appliances) for $82 million. It didn't work: UTC purchased 49 percent of Carrier for $376 million.

An abundance of surplus cash in corporate tills has been a major catalyst for mergers, there being smaller rewards for letting cash sit idle or for paying it out to stockholders.

In 1978, before buying Reliance Electric, Exxon could have bought—using only its cash and liquid assets—a 50 percent share of more than a quarter of the 500 leading industrial corporations on the Fortune magazine list, including Anheuser-Busch, E.I. du Pont, Goodyear Tire & Rubber and J.C. Penney. IBM could have done the same.

Exxon paid cash for Reliance and Shell paid cash for Belridge. RCA, completing its acquisition of C.I.T. last January, paid $900 million of the purchase price in cash. Thus the cash outlay in just these mergers totaled $5.47 billion. This was in keeping with a trend. In 1979, about 54 of 100 acquisitions were financed entirely with cash. In 1969, by contrast, only 18 of 100 were paid for—even in part—in cash.

For many corporations, obviously, buying up existing companies is simply the most appealing option. These firms may not be bargains according to classical economics, which holds that the market price reflects true value. But many of them—at least one-third of those listed on the New York Stock Exchange, according to SEC Chairman Williams—are selling below book value. And the cost of starting new companies from scratch, particularly in a roaring inflation, may be excessive.

The use of $100 billion to rejuggle existing corporate assets is troubling because, as Northwestern University's F. M. Scherer put it, "The real growth upon which our nation's prosperity depends comes only from making real investments."

He acknowledged to the Senate antitrust subcommittee that the evidence is inconclusive, but said: "One cannot help wondering, where would the cash to finance 'growth' through takeovers have gone if massive conglomerate mergers had been prohibited? How much real investment was displaced by the mere financial investment that mergers entail?"

Without equivocation, the SEC's Williams says that the $100 billion "could have been devoted to new production and employment opportunities." This money, he emphasized, does not "flow back as new capacity, improvements in productivity, innovation, new products or new jobs."

Yet the merger wave hasn't increased overall concentration of the economy, according to data from congressional hearings, the Federal Trade Commission and other sources. Instead, according to the FTC's Bureau of Competition, the wave has prevented the deconcentration that normally would have occurred in an expanding economy.

For this result, many experts put some of the blame on what they see as a tilt in the federal tax code toward mergers and bigness.

Effective tax rates have been lower for big firms: In late 1970s, firms with assets of at least $1 billion paid 24.8 percent, while firms with assets under $10 million paid 9.5 points more. The code also invites retention of earnings, which then can be used for acquisitions, and lets stockholders in acquired firms who accept stock rather than cash defer taxation.

One key index of concentration is the proportion of manufacturing and mining assets held by industrial firms.

Last year, when there were about 217,000 of them, the top 200 controlled 60 percent, compared with 57 percent in 1969. The number with assets of at least $10 billion was 11, as against five in 1969.

At the peak of the pyramid, a mere 40 of the 217,000 corporations accounted in 1979 for an estimated 31 percent of all industrial assets.

Also by 1979, 71 industrial firms had at least 50,000 employees (including 22 with at least 100,000), compared with 52 in 1966, 51 in 1967 and 61 in 1972.

In retailing, the top 40 firms accounted for 29 percent of all assets. In food processing, the top 50 of 32,000 firms accounted for nearly 60 percent of the assets and almost 80 percent of the profits. In copper, all companies owned 40 percent of domestic production facilities.

The current merger wave is the latest in a series.

The initial one, running from 1895 to 1904, saw more than 3,000 companies vanish through consolidation in industries such as distilling, railroads, steel and tobacco.

Over the next decade, 2,300 more companies disappeared into 319 industrial trusts, and 2,600 more were absorbed by 127 utilities.

For Congress, this was proof that the Sherman Act of 1890 was insufficient to prevent the creation of monopolies. So, in the Clayton Act of 1914, it included an antimerger provision intended to curb monopoly power "in its incipiency."

The provision proved to be no barrier to a new wave of mergers—4,800 of them—between 1925 and 1930. Most were horizontal—mergers of firms in similar lines of business. Some were vertical, in which customers or suppliers were acquired. Relatively few were conglomerate.

In 1950, after a new surge, Congress, in the Celler-Kefauver Act, amended the 1914 law to forbid any merger where the effect "may be substantially to lessen competition, or tend to create a monopoly."

There's no doubt of the sponsors' intent to reach conglomerate mergers, which had begun to happen and which, lacking "horizontal" limits, could forever let large firms be swallowed by larger ones, and larger ones by still larger ones. In a 1968 column, Art Buchwald foresaw the day when Samson Securities, owner of every company west of the Mississippi River, and Delilah Corp., owner of every company east of the Mississippi, would seek to merge.

But enforcement agencies and judges saw no threat to competition—as conventionally defined—in a merger of a firm making, say, chemicals with a company making papers. The result was that conglomerate mergers proliferated while horizontal and vertical mergers languished.

At one point, the Supreme Court sent an apparent signal inviting an attack on certain conglomerate mergers. The Kennedy and Johnson administrations ignored the signal, but an aggressive incoming Nixon administration swiftly filed lawsuits to block five of them.

By this time, the 1960s conglomerate merger wave was cresting. In 1968 alone, 270 acquisitions gathered up nearly one of 10 firms with assets of at least $10 million. Attorney General John N. Mitchell was warning that the "danger . . . to our economic, political and social structure cannot be overestimated."

The lawsuits were built on a theory offered by the late Richard W. McLaren, head of the Justice Department's Antitrust Division, that competition could be substantially lessened—and Celler-Kefauver violated—by certain conglomerate mergers. He specifically cited the type that joins two very large (assets exceeding $250 million) diversified firms, each a leader in a concentrated industry.

Such a merger, McLaren argued, "increases concentration in the concentrated markets in which [the two firms] may both compete," "serves also to entrench existing competition in concentrated markets wherein only one company is a leading producer," and eliminates "potential competition between the existing producer in a concentrated market and the other firm as a potential entrant therein."

Trial judges rejected McLaren's argument, as he had expected them to, but believed he had a serious chance to win in the Supreme Court. His test case was to be three acquisitions by International Telephone and Telegraph. But he lost control because in September 1971, in an atmosphere of political intrigue at the White House and Justice Department, he agreed to settle with ITT out of court.

By then, the merger wave of the 1960s had fallen into a trough. It had been foreordained to do this, because it had been propelled by unstable forces, such as speculation in "glamor" stocks, "creative" accounting and the egos of corporate "Napoleons," as they were called by the late Harry Johnson, a University of Chicago economist.

But the ITT settlement lowered the last potential high barrier to conglomerate mergers. The new wave began to roll in 1975. This time, it isn't "Chicken" money and corporate Napoleons. "It's the establishment doing it to itself," Salomon Brothers' partner Ira Harris has said.

NEXT: The impact of the merger wave on competition, efficiency, innovation and other areas.

WASHINGTON POST April 17, 1979

Conglomerates Are Drowning The Weaker Beverage Makers

Second of a series

By Morton Mintz
Washington Post Staff Writer

THE TAKEOVER GAME

In 1963, when Procter & Gamble, the nation's largest food conglomerate, bought the Folger Coffee Co., the number of coffee roasting companies large enough to be counted by the Census Bureau was 261.

Last year, there were an estimated 100 to 120.

In 1970, when Philip Morris, another conglomerate, and the second-largest firm in the cigarette industry, bought Miller Brewing, there were 82 beer producers.

Last year, there were 41.

As P&G and PM see it, it was hard competition that felled their rivals—firms less able to divine consumers' wants and to satisfy them with quality products at attractive prices. "It's the consumers and not the roasters who decide which companies will succeed and which companies will fail," a P&G representative said.

But critics of the new American merger wave of which the P&G and PM acquisitions are a part see in the coffee and beer industries disturbing illustrations of what can happen to competition when small and medium firms suddenly find themselves competing with a large conglomerate.

The effects are "chilling," says Michigan State University economist Walter Adams. The smaller firms know the conglomerate can outbid and outspend them. They also know, he says, that the conglomerate can "outlose" them—that it can cut prices and absorb large losses for as long

[illegible]

[illegible]

Folgers

[illegible]

Changes in the Number of Establishments and Jobs Resulting from Start-Ups, Closings and Relocations, by Type of Ownership: Massachusetts and New England, 1967-76

[illegible]

[illegible]

Beer drinkers must judge for themselves whether they've been helped by all of this. So far as PM is concerned, it has merely given them what they want. In buying "Lite," are they paying more for less? PM's spokesman said they obviously "wanted a low-calorie product" and "perceived a value added in that product. If they didn't," he said, "they wouldn't buy it, no matter what the price."

To meet the demand it was creating, Miller, immediately after being acquired, began to spend hundreds of millions of dollars to build new plants and undertake other capital expansion.

Despite the expense of these and other programs, the PM spokesman said, Miller operated in the black except for only one year, when it had a "very modest" negative operating income of $3.4 million. He said he based this statement on PM's consolidated annual reports.

After examining these same reports, economist Mueller said that Miller had taken heavy losses that were subsidized by PM's cigarette and other operations. In the years 1971 through 1975, he estimated, Miller lost "between $17 million and $30 million a year, for a total of $120.3 million, but made "modest profits" in 1976 and 1977.

Similar estimates were made by security analysts and F. X. Matt II, vice president of the family-owned West End Brewing Co. in Utica, N.Y. As they and Mueller read the annual reports, Miller had incurred large interest and corporate expenses attributed to the parent company. In the 1971-1975 period—when Miller was building new plants—PM recorded interest expenses alone of $800 million.

The ranks of small regional brewers already had been thinned. Of those that survived Prohibition, 750 were operating in 1940 and 260 in 1950.

In the late 1950s, after Anheuser-Busch, Schlitz and other "nationals" had engaged in selective price-cutting, many regionals went under, despite efficient plants and methods.

Thus there was a seeming long-term trend toward concentration—a trend that, for all anyone knows, might have persisted even if Miller had remained independent.

By 1978, after PM's acquisition of Miller, only 44 brewers remained. The 39 regionals among them had a mere 10 percent share of the market despite prices often several dollars a barrel lower than those of the nationals—Anheuser-Busch, Miller, Schlitz, Pabst and Coors.

In 1972 the nationals had 54.8 percent of the market, in 1978, 72.7 percent. But the principal beneficiaries of the shift to nationals were the two biggest elephants among them. Miller's share of the total increased from 4 percent to 18.9 percent. Anheuser's from 19.9 percent to 25.1 percent. The shares projected for them in 1980 are still larger: Miller 21.0 percent, Anheuser 28.6 percent.

The leftover share for all of their competitors—some of which may try to merge in self-defense—would be 33.6 percent.

As beer-buyers know, an increase in brands has accompanied the decrease in brewers. This is the result of the emulation by each of several brewers of PM's obviously successful strategies of segmenting the market and introducing and promoting brands for each segment.

In addition to competition, the merger wave, which began in 1975, has, for better or worse, affected other key areas of the economy, including efficiency, invention and innovation, international trade and industrial competence.

Here are some findings.

EFFICIENCY

One group of researchers studied 165 mergers that occurred over a decade in seven countries: Belgium, France, Germany, Holland, Sweden, Britain and the United States.

They found no overall improvement in efficiency, they reported last September. Moreover, they told a conference in Berlin sponsored by the coordinator of their project, the International Institute for Management and Administration (IIMA), the mergers had systematically increased neither sales volume nor profits.

These findings, set out in a forthcoming book edited by Prof. Dennis C. Mueller of the University of Maryland, may have particular significance for the United States.

Here, Supreme Court antitrust rulings since 1962 have virtually halted mergers of the kind that often have the greatest potential for efficiency. These mergers, called horizontal, unite a firm in one line of business with another in the same geographic area that engages in the same or a similar line.

Furthermore, horizontal mergers can achieve the economies of scale—the size at which maximum efficiency in production and distribution becomes attainable.

By contrast, conglomerate mergers join firms in unrelated lines of business. Gulf + Western operates in no fewer than 165 industrial categories—from auto parts to zinc. Beatrice Foods is in 92, International Telephone and Telegraph in 61, U.S. Industries in 77, Teledyne in 71.

Inherently, the efficiency potential in conglomerate mergers is less than in either horizontal mergers or vertical ones, which join firms to customers or suppliers.

So the IIMA study's particular significance for the United States lies in this: here, in the great merger waves of the late 1960s and late 1970s, conglomerate acquisitions—those with the lowest efficiency potential—predominated. In Europe, meanwhile, horizontal mergers predominated. Yet even these didn't improve efficiency.

Thus the study raises a question: does the conglomerate merger wave strengthen the economy of the United States or its ability to compete abroad?

INVENTION AND INNOVATION

U.S. industrial technology leads the world and is much feared in Europe, especially in France, says William James Adams, who heads the University of Michigan's Center for Western European Studies.

The French government, in a defensive maneuver, has promoted mergers in the belief that only larger companies can do the research and development (R&D) that will enable French industry to compete effectively, over the long pull, against U.S. firms.

Adams studied the results of the French effort and came away unimpressed. "Bigness is not a prerequisite for progressiveness," he wrote in an analysis in the Quarterly Journal of Economics.

As for the United States itself, there's a good deal of evidence on the relationship between company size and the environment for invention and innovation. A sampling:

"WE HAVE ONE SIMPLE OBJECTIVE: TO BE NO. 1. THAT'S WHAT WE ARE AFTER, AND THAT'S WHAT WE'LL DO."
—Miller Brewing Co. President John A. Murphy

- With only 3.5 percent of federal R&D dollars, a Commerce Department study found, very small business was responsible for more than half of all important scientific and technological inventions in the first two-thirds of the 20th century.
- Between 1953 and 1973, the Office of Management and Budget found, firms with fewer than 1,000 employees produced nearly 50 percent of all major U.S. innovations. As compared with larger firms, they produced four times as many innovations for each R&D scientist or engineer on the payroll.
- In the same 20-year period, the National Science Foundation concluded, firms with up to 1,000 employees produced four times as many innovations per R&D dollar as firms with 1,000 to 10,000—and 24 times as many as firms with more than 10,000.

• One of the truly revolutionary inventions of the 1970s was the microprocessor, a tiny silicon chip that, in its first version, processed as much data as 2,000 transistors. Marcian Hoff of Intel Corp. of Santa Clara, Calif., made the invention in 1971, three years after Intel was founded—with 16 employees.

Few are better positioned to address the issue than William C. Norris, who has been in both acquired and acquiring companies. He started Control Data Corp., built it into one of the nation's 200 largest industrial corporations, and is Control Data's chairman and chief executive officer.

"Bureaucracy in large companies drives away the innovators," Norris says.

INTERNATIONAL TRADE

Sen. Adlai E. Stevenson (D-Ill.) and Donald I. Baker, former head of the Justice Department's Antitrust Division, are among those who warn against restrictions on conglomerate mergers.

Stevenson, expressing a view of the so-called University of Chicago "school," told the Senate antitrust subcommittee last year that such laws could "reduce the ability of U.S. firms to compete in world markets with foreign conglomerates and with known brand names and worldwide marketing systems."

Baker, testifying for the National Association of Manufacturers, emphasized that other nations "are attempting to increase the ability of their industries to compete more effectively in the international marketplace by encouraging the growth of mergers and cartels and by otherwise subsidizing their domestic industries."

By contrast, the University of Michigan's Adams says such advice reveals unfamiliarity with economic realities in Europe and Japan. He said in a phone interview:

"There are very few industries in which the largest firms are not American. And yet we hear complaints that it is the size of American firms that jeopardizes the American position in world markets. If that is so, it must be because our firms are too large and sclerotic, rather than because they are too small."

Agreeing, Kenneth M. Davidson, deputy assistant director of the Federal Trade Commission's Bureau of Competition, asks, "How much bigger does General Motors or Ford need to be to compete with Volvo or Toyota?" In 1978, GM's sales were $63.2 billion, Ford's $42.8 billion, Volvo's $4.2 billion, and Toyota's $12.8 billion. Troubled Chrysler's were $13.6 billion.

MANAGERIAL COMPETENCE

Mergers are "an important device for disciplining incompetent managers," the University of Chicago's Richard A. Posner told the antitrust subcommittee. This view is supported by business groups including the National Association of Manufacturers, for which Posner testified, and doubtless by certain specific cases. But its importance is questioned by some executives responsible for major acquisitions and by profit data.

When United Technologies Corp. picks a target, UTC chairman Harry J. Gray said in a 1978 interview, "we want it to be a market leader and profitable No. 1, 2, maybe 3 in the market . . . we'd like to have a competent management. And so far, in every one of the acquisitions we've made, that has been the case."

Similarly, Mobil's senior vice president for finance, James Q. Riordan, has testified to "looking for companies that were well managed . . . The purpose of our acquiring Marcor . . . was not because we thought we would make Montgomery Ward dramatically more efficient." In fact, Mobil retained Marcor's management.

Companies that are bought up tend—predictably—to be profitable ones.

The FTC's Alfred F. Dougherty Jr., head of the Bureau of Competition, cites profit data for the 80 companies bought for at least $100 million each in 1978.

Past profitability records were available for 57 of the firms. They show a 1977 average net return on stockholders' equity of 13.9 percent. That is one point higher than the composite for the Fortune magazine 1,000 industrials plus the 50 leaders in each of five other categories: commercial banking, diversified finance, retailing, transportation, and public utilities. For 35 of the firms, the 13.9 percent return was larger than in 1976.

NEXT: Impacts of the merger wave on communities and the democratic process.

WASHINGTON POST
April 30, 1979

Community Dislocations: A Painful Side Effect of Merger

Last in a Series

By Morton Mintz

Washington Post Staff Writer

For NN Corp., an insurance holding company in Milwaukee, 1978 was another good year. Its profit, on revenues of $429 million, was 7 percent after taxes. Its after-tax return on equity was 20 percent.

Those are golden numbers. They make NN Corp. appetizing to other companies. At least 20 would-be buyers have nibbled at NN since 1973.

None of the takeover proposals succeeded. But chairman and chief executive officer William M. Berry listened to each one. His responsibility to NN's shareholders required him to, he told a reporter.

Berry is also what he calls "a corporate citizen of Wisconsin." As such, he took on an unusual additional responsibility a year ago: to tell a hearing of the Senate Select Committee on Small Business of his concern—shared by other Wisconsin executives—"about the negative effects of takeovers on the community."

Community dislocations have long been part of the industrial landscape, painful side effects of the corporate drive toward lower costs and higher profits.

But today there is a new dimension to this old problem. The reason is the wave of conglomerate mergers that has swept across the economy, takeovers of companies like NN by what amount to distant corporate holding companies.

One of Berry's concerns was the financial loss to a state and city when, as often occurs after a takeover, a local firm's headquarters is closed. Had NN's been shut, he figured, the loss to Wisconsin and Milwaukee—in 1978 alone—would have been $3,461,394, half of it pay for 71 employes.

He put a value of $411,359 on the contributions and pledges by NN and its charitable foundation into a host of state and city community causes.

These involved $57,709 to the United Way, in addition to $15,491 given individually by employes. The United Way often has found it "difficult to get much in the way of donations or cooperation from companies that are owned by out-of-state conglomerates," Berry testified.

In addition, the philanthropic contributions included $77,698 to the University School of Milwaukee, $60,000 to Milwaukee Children's Hospital, $17,500 to the United Performing Arts Fund, and $7,500 to the Milwaukee Symphony.

'Conglomerates or outsiders usually eliminate this type of expenditure," Berry told committee Chairman Gaylord Nelson (D-Wis.). "They have their own causes, their own headquarters city and state, and different corporate purposes to serve in their contributions. Places like Milwaukee and Wisconsin are far away and unimportant to them."

At the same time, in many communities, local managers for large corporations based elsewhere take leadership roles in raising funds for charitable and civic activities.

Other witnesses told of acquisitions of Wisconsin firms that had been followed by the swift transfer of banking, insurance and other professional functions to the out-of-state headquarters of the acquiring conglomerate.

This testimony lent an importance beyond their dollar amounts to three relatively small items listed by Berry in his state-city loss estimate of $3.5 million: $86,194 to two Milwaukee banks for interest charges, $819,388 to local insurance agents for corporate coverage, and $682,762 to local professional firms for accounting, legal and other services.

Berry is but one of many local businessmen across the country who say that decision-makers in distant conglomerate headquarters often don't have—and can't reasonably be expected to have — the same concerns as owners rooted in the community. They say the same is true of numerous conglomerate managers.

Such feelings pervaded a two-day hearing in Syracuse, N.Y., in 1978, when three dozen upstate businessmen recalled traumatic aftermaths of several regional mergers.

They told Milton D. Stewart, the Small Business Administration's chief counsel for advocacy, of being displaced as long-time suppliers by centralized conglomerate purchasing, of emptied factories, of disrupted lives and communities, and of generalized fears for the future of small business.

Much of the feeling of unease about conglomerates was summed up by Theodore Pierson, whose Onondaga Supply Co., he noted, "does 75 percent of its business with corporate giants and conglomerates."

Conglomerates, Pierson testified, "can take vital decisions for a community out of the community, and they can affect the lives of the families of their employes by decisions at a remote corporate headquarters."

And last February, the House Small Business antitrust subcommittee heard two economists testify that conglomerates "are among the businesses most responsible" for massive shifts of capital and jobs not only within the United States, but also to "low-wage, underdeveloped countries."

The witnesses, Barry Bluestone of Boston College and Bennett Harrison of Massachusetts Institute of Technology, also testified that their research "has demonstrated quite clearly that conglomerates are responsible for more plant closings than either large corporations or small business," sometimes because they are less willing to ride out a business downturn than local owners closely tied to the community.

Harvard's Belden Daniels offers a case in point: the 1974 acquisition by Sheller-Globe of Toledo, mainly a maker of auto parts, buses and ambulances, of Colonial Press of Clinton, Mass., a book printer.

Like other conglomerates such as Esmark, Sheller-Globe billed subsidiaries for management services—an average of $600,000 a year for Colonial. Some of the services weren't wanted, including construction of a big chain-link fence and the stationing of 22 security guards. The theft level had been so low that it "couldn't possibly" justify the costs, Daniels says.

More fundamentally, Sheller-Globe imported a new team of production-oriented managers with no publishing experience. Daniels says the result was chaos: lost orders, collapsed relationships with key customers, and, via installation of a costly computerized management information service, lost books and "terrible confusion" in production.

In the end, Daniels says, sales sagged as book publishers took their business elsewhere. Sheller-Globe finally announced its intention to shut down Colonial. By that time, the number of jobs at Colonial—Clinton's largest employer—had shrunk from about 2,000 to 750.

Conglomerate managers may set goals such as a target profit or market share for a subsidiary, close it for falling short, and seek better investments elsewhere. When the result is a plant closing that devastates a community and burdens taxpayers with welfare and other costs, there's a question about defining managerial competence solely in terms of a conglomerate's interests and no one else's.

Some cases in point:

- In Herkimer, N.Y., a century-old library furniture plant was the leading employer and customer for area-grown hardwood logs. Starting in 1960, its after-tax return on investment was a low 3 percent to 4 percent. In 1976, Sperry Rand, the conglomerate owner, decided to close the plant. Then, reluctantly, Sperry agreed to sell it to the Mohawk Community Corp. (MCC) for $4.3 million.

In a single day, the 270 workers raised the $197,500 down payment—knowing it would be forfeited if the balance was not raised in 45 days. A loan of $2 million was made by seven local banks after their conditions were met: the MCC must sell 1 million shares of stock at $3 each, and the Economic Development Administration must lend $2 million more.

With the $4.3 million oversubscribed, the plant for the first time began to sell to U.S. corporations and to do business abroad. Its after-tax profits under the first year of new ownership was 14 percent.

Losing almost $1 million in its second year, the MCC brought in a new president, reduced its 1979 loss to $300,000, and has been profitable every month in 1980, said MCC official John M. Ladd. It also expanded the work force by 25 percent and sales by $6 million annually, he said.

- In the shaving market, Philip Morris had hoped to make American Safety Razor of Staunton, Va., into an effective challenger of dominant Gillette and Schick, but had failed to win a market share of more than 12 to 14 percent.

Finally, PM, preoccupied with its beer and cigarette lines, and having had five consecutive years of losses at ASR, ordered the plant closed. But nine ASR managers, pooling $800,000 of their own money with bank and federal loans, bought the company for $15 million in October 1977. About 800 jobs were saved. And, says chief financial officer Grey Ferguson, ASR has been operating at an undisclosed but "encouraging" profit ever since.

Sometimes a company refuses to sell a plant, or a community or employes can't buy it. That can lead to trouble, as illustrated by United States Steel.

USS is one of the industry leaders that went on building obsolete open-hearth capacity long after it could have put in efficient oxygen furnaces. Not until 1969—about a decade after two small steel companies had installed oxygen furnaces—did USS do so. Then, with the outlook for domestic steel darkening, USS became one of the major steelmakers that diversified heavily into nonsteel activities, and that now complain of being unable to compete with foreign steel.

Small Business Key to Jobs

Over a seven-year period ended in 1976, the number of jobs in the private sector increased by 5.7 million.

The 1,000 largest industrial corporations accounted for 76,897 of them, or 1.3 percent, according to a calculation made in 1978 by a House Small Business subcommittee. Smaller firms accounted for the rest—98.7 percent.

The figures call into question the impacts on job creation of the merger wave, in which an estimated $100 billion in corporate assets has been rejuggled—mainly by big firms that have become bigger by acquiring smaller companies.

In a new study, economist David Birch of the Massachusetts Institute of Technology has found that employment in firms acquired in mergers grew at somewhat lower rates than in similar independent companies.

"Historically, small business has created the bulk of new jobs," William K. Eastham, board chairman of the U.S. Chamber of Commerce, told the subcommittee. "If problems of employment are to be resolved, it is likely that we must depend on small business as a principal factor in the solution."

Harold M. Williams, chairman of the Securities and Exchange Commission, says pointedly that the estimated $100 billion spent in the merger wave, now in its sixth year, could have been but was not "devoted to new production and employment opportunities."

Recently, USS announced that it will shut down 13 steel plants. The Labor Department has notified the company that the closings could cause local distress for which the government would have to pick up the tab, a department official told a February hearing of the House Small Business antitrust subcommittee. Chairman Berkley Bedell (D-Iowa) foresaw "a heavy burden to the taxpayers . . ."

Two of those plants, comprising the Youngstown Works in Ohio, would be acquired, modernized and restored to operation under a plan proposed by a community-worker venture. But USS refuses to sell the plants to the enterprise on the ground that it would use low-interest federal loans. A complaint that the company was violating the antitrust laws was dismissed in U.S. District Court.

Now Ohio Attorney General William J. Brown is asking the court to order USS to deal with all prospective purchasers, arguing that its refusal to do so simply because a potential competitor would have federal loans or loan guarantees was illegal discrimination. The company is threatening Ohio's economy with "grave and irreparable harm," Brown has charged.

***

Beyond the social impacts of the merger wave are the political implications of concentrating economic power.

Obviously, a company that acquires plants in several states acquires more political leverage, too. It gains easy access to more officeholders at relatively low cost. It gets more for its money through such means as political action committees, lobbying, and "advocacy" advertising.

International Telephone and Telegraph made the point in 1966 when it made its ultimately unsuccessful effort to acquire American Broadcasting. ITT, which had 236 subsidiaries, 200,000 shareholders and 400,000 employes, mustered some 300 members of Congress to protest the Justice Department's opposition to the proposed merger.

Some business groups and economists try to deflect concern by saying that mergers haven't been shown to have concentrated either economic or political power. "The political muscle in large corporations is practically nonexistent," a reporter was told by Thomas G. Moore of the Hoover Institution on War, Revolution and Peace.

Moore's claim, of course, is disputed.

That is part of a more general dispute about the value of mergers.

There is no doubt that some mergers are on balance beneficial: that they enhance competition, infuse needed capital into companies, help remove incompetent managers, enrich stockholders.

But other mergers, for all kinds of reasons, are not so benign.

The question is whether the government ought somehow to restrain mergers, sort out the good and bad, let only the "good" go forward.

So far the answer has been no.

Congress, by not restraining the merger wave, is letting it roll. Business groups defend this decision, or nondecision, saying there's no "proof" of a need for curbs on acquisitions. Others say that to wait for proof is to wait until mergers have transformed the nation irreversibly.

Last May, Sens. Edward M. Kennedy (D-Mass.) and Howard M. Metzenbaum (D-Ohio), who succeeded Kennedy as chairman of the Senate antitrust subcommittee, introduced a bill to bar the 16 largest oil companies (Sun ranks 10th) from buying any firm with assets exceeding $100 million. The bill won a Carter administration endorsement and has been reported by the Senate Judiciary Committee.

On a back burner is a more sweeping bill sponsored by Sens. Kennedy, Metzenbaum, John F. Melcher (D-Mont.) and Larry Pressler (R-S.D.). This measure, on which hearings have been held, would allow the very largest mergers only if there's a showing that they would improve either competition or efficiency.

Taking a different approach, the Federal Trade Commission's Bureau of Competition, instead of ruling out any merger, would let one large firm acquire another only if it divests a comparable entity within a reasonable time.

A wholly different tack is urged by William C. Norris, chief executive officer of Control Data Corp.: require a "social impact analysis" so the stockholders of the firms in a proposed merger can judge the effects on jobs, careers, productivity, innovation, communities and themselves.

Numerous other ideas have been suggested. One of the simplest: heavily tax undistributed profits. That would drain a lot of fuel out of the merger tank.

What Will Big Oil Firms Do With All That Money?

By Morton Mintz
Washington Post Staff Writer

What will the big oil companies do with all that money?

As a result of decontrol of oil prices, they will accumulate extra estimated net income of $200 billion—after paying the newly enacted tax on crude—by 1990.

This year's first-quarter earnings—more than double those of the same period in 1979—are but a first small installment.

Moreover, as The Washington Post reported Thursday, a controversial new accounting technique ordered by the Securities and Exchange Commission led the 11 largest U.S. oil companies to estimate that the present value of the future flow of cash from their oil and gas reserves rose last year by $95.1 billion—from $182.7 billion to $277.8 billion.

Over the next decade, will the companies invest most or all of their huge profits in exploration and development as some of them would have the country believe?

Or will the companies go on a binge of acquisitions, thus extending the great merger wave in which an estimated $100 billion of existing corporate assets has been swapped since 1975?

Many experts say the companies really have no choice but to buy up other companies, inside or outside of the energy industry. One reason is that the industry has what University of Maryland economist Dennis C. Mueller terms "a finite time horizon."

Just how soon the world will "run out of oil" is disputed, Mueller told the Senate antitrust subcommittee last year. "Nevertheless, the leading companies in the industry have to diversify if they are to maintain their position on Fortune's 500 well into the 21st century."

In a recent interview, another economist, who has worked in the oil industry and in federal agencies dealing with energy, said the companies are generating more cash than "they intelligently can spend."

He calculates the industry can spend no more than $12 billion for new drilling in the continental United States before it becomes uneconomic.

The economist, who asked that his name be withheld, predicted the companies gradually will produce less domestic oil while shifting emphasis to refining, marketing and acquisitions, particularly of other energy producers.

Three oil company acquisitions are possible omens.

- Just last month, Sun Oil won conditional acceptance for the second largest acquisition in the nation's history when it offered to buy Texas Pacific, an oil and gas producer owned by Seagram Co. Sun will pay Seagram either $2.3 billion in cash or, at Sun's choice, $800 million in cash and two notes of $800 million each.
- In 1979, Shell Oil made the largest acquisition in U.S. history when it paid $3.65 billion in cash for Belridge Oil.
- In another huge cash acquisition in 1979, Exxon paid $1.18 billion—almost double the market price of the stock—for Reliance Electric, a leading maker of electric motors.

Appendix NN.—Canada's Foreign Investment Review Act

Staff note: Canada has a Foreign Investment Review Act that sets criteria to determine whether investment by a foreigner is likely to be of significant benefit to Canada. These criteria can be used as a guide to evaluate the effects a merger may have on a community.

Foreign Investment Policy

Canada's policies towards foreign investment seek to reconcile two realities. On the one hand, there is the uniquely high degree of existing foreign ownership and control of Canadian industry as a result of heavy foreign direct investment in the past. On the other hand, there is a continuing need for foreign investment, both direct and portfolio, to supplement Canadian savings in financing the future development of the Canadian economy. Canadian policy therefore welcomes foreign investment, provided that, in the case of foreign direct investment, it is likely to yield benefits to Canada as well as to the investor.

The fabric of Canadian Government policies and measures relating to foreign direct investment contains a number of strands. There is a group of measures that might be called safeguards; like similar measures in other industrialized countries, they are aimed at ensuring that certain vital national interests are protected and maintained. They include legislation covering key sectors of the economy, requiring that most or all of the sector will be Canadian-owned and controlled. They apply to such sectors as banking, other financial institutions, broadcasting and newspapers. Direct government participation in broadcasting, rail and air transportation, nuclear energy, and Arctic oil and gas exploration is another means of maintaining a Canadian "presence" in the more crucial areas of activity.

A second group of measures is designed to encourage the growth of strong Canadian-controlled enterprises and to encourage the investment of Canadian savings in Canada. They include measures in support of small businesses, measures to retain more pension fund savings in Canada, and the creation of the Canada Development Corporation to attract Canadian savings into the development of strong Canadian-controlled businesses.

The Foreign Investment Review Act

The centre-piece, however, of Canada's legislative approach is the Foreign Investment Review Act. The Act provides a mechanism to screen certain foreign direct investment proposals to determine whether or not those investments are likely to be of significant benefit to Canada. The Foreign Investment Review Act applies to two, and only two, forms of foreign investment:

- the acquisition of control of a Canadian business enterprise by foreign individuals, corporations, governments or groups containing foreign members, through the acquisition of shares or of the property used in carrying on the business; and
- the establishment of a new business in Canada either by foreign persons who do not already have an existing business in Canada, or by foreign persons who have an existing business in Canada, if the new business or expansion is unrelated to the existing business.

With respect to acquisitions, it should be emphasized that the Act is concerned with the acquisition of control of Canadian business enterprises, not with the acquisition of shares or assets where that acquisition does not constitute control. Thus, portfolio investments are generally not subject to review.

Some of the important features of the Act need special mention. First, the Act is not retroactive. It does not seek to regulate or review investments made by non-Canadians prior to the entry into force of the legislation. Second, the Act does not provide for discrimination among investors on the basis of their country of origin. Third, the Act applies generally and is not confined to particular sectors of the economy. Finally, the emphasis of the Act is on business and economic performance standards and the Act sets out "significant benefit to Canada" criteria against which business performance is assessed.

Significant benefit is determined by taking into consideration the following factors, or as many of them as are applicable in a given case:

(a) the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada;

(b) the degree and significance of participation by Canadians in the business enterprise and in the industry sector to which the enterprise belongs;

(c) the effect on productivity, industrial efficiency, technological development, innovation and product variety in Canada;

(d) the effect on competition within any industry or industries in Canada; and

(e) the compatibility of the investment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by a province likely to be significantly affected by the proposed investment.

The relative significance or weight attached to each of these factors is not, and cannot be, the same for all investment proposals. It necessarily varies with the nature of the transaction, the industry sector in which it falls, the region in which the investment is being made, and a number of other factors.

The Act provides for the establishment of an agency, the Foreign Investment Review Agency, to advise and assist the Minister responsible for the administration of the Act. The responsible Minister is the Minister of Industry, Trade and Commerce.

The Minister is empowered under the Act to issue Guidelines to clarify the intended interpretation of the various provisions of the Act. Guidelines have been issued concerning the application of the Act to *real estate transactions*, certain transactions in the *oil and gas industry*, *corporate reorganizations* and certain *venture capital investments*. The Minister has also issued Guidelines indicating how he intends to interpret the terms "*new business*" and "*related business*" for purposes of the Act.

The Minister is required by the Act to give individual opinions on two matters upon request by the investor, (i) as to whether the investor is or is not a "non-eligible person" (i.e. non-Canadian) and (ii) as to whether a proposed new business is or is not "related" to an existing business in Canada of the investor. These opinions are binding on the Minister for a period of two years so long as all the material facts were disclosed to the Minister at the time of the request for an opinion and the facts so disclosed remain substantially unchanged.

Aside from the Guidelines and formal Ministerial opinions, a great deal of informal advice and assistance to investors is provided. Investors are encouraged to discuss the circumstances of their investments informally with Agency officials. The experience to date indicates that many questions can be disposed of quickly with consequent savings of time and expense. Informal consultations on the formulation of applications are especially helpful to investors and their advisors.

Appendix OO.—Statement of the Business Roundtable on Conglomerate Mergers

INTRODUCTION

The Business Roundtable, an association through which the chief executive officers of some 190 U.S. companies focus and act on public issues, is seriously concerned about the current drive to impose added restraints on American business in the form of new anti-merger legislation.* This is not to say that the actions of the economic sector of our society should not be brought up for review. Of course they should be and we are encouraged by the fine spirit of cooperation that the members of this Subcommittee are demonstrating. We need to work together to identify what, if any, problems exist and what are the most appropriate and sound public policies to deal with them.

The Roundtable's Economic Organization Task Force has delved deeply into the issues because they are important and merit debate. What we would like to do in this paper is to give a brief overview of where we think the business community is on the issue of conglomerate mergers.

Let us begin by stating that The Business Roundtable, and the business community at large support the antitrust laws which protect unfettered competition as the rule of trade. Legislation designed to shield the nation's markets from unreasonable restraints of trade and monopolies is in the best interests of both consumers and business.

Proposals for new merger restrictions, however, will not protect competition and may, in fact, impair it. A basic problem with size limitation proposals are that they have little if anything to do with antitrust, competition, or economic performance. Rather, such proposals seem to be based on amorphous and undefined social and political concerns.

We should be very careful not to jeopardize this nation's economic health. Nor should we introduce substantial new government interference in the marketplace, impeding the country's economic growth and progress, and undermining its ability to compete effectively in today's world-wide markets, without substantial assurances that the benefits to be achieved by such interference will outweigh its costs.

There may very well have been some corporate mergers that have proven to be undesirable from either an economic or social viewpoint. But there is no reason to condemn all mergers by arbitrarily prohibitive law, especially when it is clear that the vast majority of the actions of the business community serve the purposes of society.

**See*, *e.g.*, S.600, S.1246, 96th Cong. 1st Sess. (1979)

Basically, the American people, whom we all serve in our respective capacities, have given two assignments to the business sector: the first to produce for them quality goods and services at a price they can afford to pay, and the second to provide jobs for those who wish to work.

The economic organization of our country thus far has been reasonably successful. We have indeed supplied an abundance of goods and services which the American people can afford and have enabled them to get these goods in better quality and at lower cost than most other nationalities. Employment in the United States is at the highest level ever, and the twenty million Americans who will enter the work force for the first time in the next ten years have good expectations of earning their livelihood in the private enterprise sector of our society.

Let us not take a chance of crippling something that has worked very well without strong evidence to support a change. What are the evils that we are trying to avoid? If these evils are real rather than imaginary, can we get at them without crippling our economic organization? Last year, the Senate Judiciary Committee held extensive hearings on these and other relevant questions, and we believe the answers that were found establish a compelling case against any new anti-merger legislation.*

PRESENT ANTITRUST LAW PROHIBITS ANTICOMPETITIVE MERGERS

First, we should note that present law prohibits anticompetitive mergers. Section 7 of the Clayton Act, as this Subcommittee is well aware, already prohibits mergers where their effect "may be substantially to lessen competition, or to tend to create a monopoly." Antitrust attorneys emphasize the word "may" because this statute, as interpreted by the courts, prohibits any merger that even raises a significant possibility that competition may be reduced.**

---

*Hearings Before the Subcommitteee on Antitrust, Monopoly and Business Rights of the Committee on the Judiciary of the United States Senate, on S.600, 96th Cong., 1st Sess. (1979) ("Hearings on S.600".)

**See, e.g., Statements and Testimony of Professor Richard A. Posner (April 26, 1979), Donald I. Baker (April 26, 1979), Ira M. Millstein (April 26, 1979), Hearings on S.600.

Legislative proposals introduced in the Senate do not address any traditional concern about protecting competition. Those concerns have been dealt with by existing law. Rather, the advocates of restrictive legislation, as they candidly have admitted, seek to achieve social objectives, on the assumption that there is a direct causal connection between corporate size--whether the product of mergers or not--and adverse effects upon social values.

This assumption is an issue which has only recently been exposed to any serious study. Indeed, it was just last month that the Federal Trade Commission concluded a two day conference on the social and political effects of large firm size* in which the principal researchers involved in this area reached the virtually unanimous conclusion that, at the present time, we have very little hard evidence on these issues and that the need for further study is paramount. Moreover, as will be discussed below, what hard evidence we do have — on the economic impact of acquisitions — argues strongly against any new merger restrictions.

THERE IS NO CREDIBLE EVIDENCE TO SUPPORT THE CLAIM THAT LARGE MERGERS CAUSE SIGNIFICANT PROBLEMS WHICH ARE NOT ADEQUATELY DEALT WITH BY EXISTING LAW

The proponents of new merger restrictions appear to rest their arguments on three basic claims:

FIRST, it is claimed that recent mergers are not economically rational and that takeovers are the result of "empire building" by corporate barons;

SECOND, it is claimed that mergers have already caused a dangerous concentration of aggregate economic power;

THIRD, it is claimed that mergers have led to significant adverse social and political consequences.

---

*FTC Conference, "The Economics of Firm Size, Market Structure and Social Performance" (January 17-18, 1980).

If these claims were true, we would agree that we have a serious problem against which alternative legislative solutions should be measured. However, the evidence we have seen clearly indicates that not one of these claims is supportable. Moreover, by proscribing rational merger activity, Congress will impose enormous new costs on the economy. The result would be a net loss for society by a wide, wide margin.

MERGER ACTIVITY IS A RATIONAL AND PRODUCTIVE RESPONSE TO ECONOMIC FORCES

Let's look at the claim that current mergers are the result of arbitrary power. The alleged power of a chief executive officer is circumscribed by the strict discipline of the marketplace, the shareholders of the business, and the board of directors who represent them, as well as a host of governmental laws and regulations already in place.*

The claim that mergers are generally arbitrary and do not make good economic sense is simply untrue. Ironically, it appears that, to a large extent, merger activity is a function of government policies affecting the capital market. As the Chairman of the FTC, Mr. Pertschuk, testified in 1979 before the Senate Judiciary Committee:

> "...The current merger wave is explained in significant part by such factors as the undervaluation of many stocks, the tax disincentives to increased dividend distribution, the current rate of inflation, and the continued growth of the economy..."

It is instructive to consider these economic forces from the perspective of both the acquired and acquiring company.**

From the point of view of the acquiring firm, the economy's recent expansion at a time of great inflation has generated large cash flows for successful companies. These funds can, of course, be distributed to shareholders as dividends, but government tax policies, particularly the policy of double taxation of corporate dividends generally render it in the shareholder's best interest for a great portion of these funds to be reinvested. The question, then, is *where* to invest.

---

*See Testimony of Ira M. Millstein (April 26, 1979), Hearings on S.600.

**See generally, Statement and Testimony of Professor George J. Benston (May 17, 1979), Hearings on S.600.

In determining which investment opportunity to pursue, a company must consider the following facts of contemporary economic life.

Many U.S. industries are not able to absorb all of a company's residual cash flow in their current businesses. Such industries encompass either maturing product markets with limited opportunity for growth; markets in which foreign competitors have distinct advantages in the form of government subsidies or access to inexpensive labor; or cyclical markets which require that the prudent company diversify into other fields. Whichever may be the case, investment in such markets is risky in relation to reward and may often not be economically desirable in light of alternative investment opportunities.

Similarly, *de novo* entry into a developed industry usually requires enormous capital and market development investments involving large risks which are particularly substantial for a large company accountable to hundreds of thousands of shareholders. There are real limits, both fiduciary and otherwise, on such a company's ability to move into an established market.

On the other hand, it is common knowledge that the stock price of many existing firms has fallen substantially below the replacement value of their assets. That means such firms will often be among the most attractive, rational options available to a large company seeking investment opportunities. It should be emphasized here that this depression in stock prices has primarily been the result of the atmosphere of uncertainty arising from the increasing costs of government regulatory programs, taxation, vacillating policy and inflation born of unsound fiscal and monetary practice.

All things considered, therefore, existing economic forces often render acquisition the most rational investment alternative for successful corporations.

Similarly, from the point of view of the acquired firm, the merger market is frequently the best option for raising needed capital or selling out the company's holdings.* Specifically,

---

**See, e.g.*, Statements and Testimony of Professor George J. Benston (May 17, 1979), L. Earle Birdzell (May 17, 1979), James C. Wheat, Jr. (May 17, 1979), Professor J. Fred Weston (April 25, 1979), Professor Michael Gort (April 25, 1979), Professor Yale Brozen (April 25, 1979), Hearings on S.600.

the stock market is not a viable alternative for entrepeneurs who wish to raise capital or sell out their interests at a price approximating the economic value of their company. This again is because of the depression of the equity market, inflationary interest rates and a scarcity of private investors which have rendered the raising of needed capital at a reasonable cost very difficult.

So we can see that, both from the standpoint of the acquiring and acquired companies, it is clearly incorrect to assert that the current merger trend is the result of arbitrary decision-making. Most mergers make perfectly good economic sense and, if they do not, the market will quickly cause an adjustment.* The concern with merger activity by Congress should be directed to the underlying economic forces, including the many governmental policies which influence them.

MERGER ACTIVITY HAS NOT CAUSED A SIGNIFICANT INCREASE IN AGGREGATE CONCENTRATION

Turning now to the second claim by advocates of new anti-merger legislation--that mergers are a substantial cause of high concentration. The evidence shows this to be a distortion of what has really taken place. All of the experts agree** that the data is so confused and inadequate that only one conclusion can be drawn: "Neither the concept nor the numbers on aggregate concentration represent clean or clear bases for a national policy that would reshape the organization of the economy."***

---

*See, e.g., Statements and Testimony of Professors George J. Benston (May 17, 1979), L. Earle Birdzell (May 17, 1979), Yale Brozen (April 25, 1979), J. Fred Weston (April 25, 1979), Jesse W. Markham (April 25, 1979), Michael Gort (April 25, 1979), Philip Cagan (April 25, 1979), Hearings on S.600.

**See, e.g., Statements and Testimony of L. Earle Birdzell (May 17, 1979), Dr. Betty Bock (April 25, 1979), Professor J. Fred Weston (April 25, 1979), Professor David Schwartzman (April 25, 1979), Hearings on S.600.

***Testimony of Dr. Betty Bock (April 25, 1979), Hearings on S.600.

The picture painted of economic power being concentrated in fewer and fewer hands is not supportable. The fact is that there are *more* large companies today than ever before and that there has been substantial turnover among the ranks of the largest companies. Furthermore, there is significant new research indicating the complete absence of any relationship between mergers and variatons in the levels of concentration.* So it is simply a fallacy to contend that one causes the other.

Finally, the data show that the rate of net business formations has been increasing, including small businesses. "In fact, paradoxically there is a correlation between merger activity and new business formations...".**

In short, there is no credible basis to contend that concentration has become a greater problem than before, or that mergers are causing concentration.

THERE IS NO CREDIBLE EVIDENCE TO SUPPORT THE CLAIM THAT LARGE MERGERS CAUSE ADVERSE SOCIAL AND POLITICAL CONSEQUENCES.

There is no reasoned basis for concluding that a causal connection exists between large-firm size or large mergers and "bad" social or political consequences. Since responsible, scholarly research into the social and political consequences of large mergers is only now beginning, no one has any scientifically-tested data to support any conclusions.

The debate is thus reduced to a war of anecdotal incidents as to plant openings or closings, employment gains or losses, and so on. Of course, discussion of specific mergers is instructive to illustrate, for example, the inducements and motivations for mergers from an economic standpoint, as well as the resultant impact of a particular merger in various areas. But anecdotes cannot substitute for the scientific and empirical framework that would be necessary to meaningfully address a claim that large mergers *inherently* cause social and political problems.

***See, e.g.*, Statements and Testimony of Professor David Schwartzman (April 25, 1979), Professor J. Fred Weston (April 25, 1979), Dr. Betty Bock (April 25, 1979), Hearings on S.600.

**Testimony of Professor J. Fred Weston (April 25, 1979), Hearings on S.600.

If anything is clear it is that such a framework is presently lacking. There is simply no hard data available on the social and political impact of mergers. Much work is going on, as demonstrated by the recent FTC conference,* to gather and study such data. Furthermore, the hearings held last year on S.600 emphasized the important point that there is no justification for any general statement regarding adverse consequences of mergers.**

NEW ANTI-MERGER LEGISLATION WILL HAVE DEVASTATING ECONOMIC CONSEQUENCES FOR THE NATION.

Unable to support their concerns about merger activity with any hard facts, the proponents of new antimerger legislation have taken the position that even the remote possibility of some resultant social benefit should be enough to support new merger restrictions because, in their view, a ban on large mergers would be "economically neutral" and thus a costless experiment for society at large. This argument simply makes no sense.

Whenever a rational economic decision is prohibited, there are going to be costs. The more important the decision, the more substantial the costs. That is just plain common sense.

Therefore, the proposed ban on mergers--which in reality is an attack on rational investment decisions involving hundreds of millions of dollars--would have disastrous economic consequences for the nation. Consider the following facts which were brought to light at last year's Senate hearings:***

---

*FTC Conference, "The Economics of Firm Size, Market Structure and Social Performance" (January 17-18, 1980).

**See, e.g., Statements and Testimony of Ira M. Millstein (April 26, 1979), Professor Edwin M. Epstein (April 26, 1979), Professor William F. Baxter (April 26, 1979), Professor Gorden Tullock (April 26, 1979), Hearings on S.600.

***See, e.g., Statements and Testimony of Professors George J. Benston (May 17, 1979), Yale Brozen (April 25, 1979), J. Fred Weston (April 25, 1979), Jesse W. Markham (April 25, 1979), Michael Gort (April 25, 1979), Philip Cagan (April 25, 1979), Kenneth W. Dam (April 25, 1979), Hearings on S.600. See also, Statements and Testimony of L. Earle Birdzell (May 17, 1979), Margaret Sullivan (May 17, 1979), Michael Bell (May 17, 1979), Ralph Wells (May 4, 1979), Professor Richard A. Posner (April 25, 1979), Professor William F. Baxter (April 25, 1979), donald I. Baker (April 25, 1979), Hearings on S.600.

First, mergers often provide an important check upon the quality of managerial performance. When a company is run inefficiently, its stock price will usually decline, thus making the company an attractive investment opportunity for a firm that can run it at its true economic potential. Prohibiting such acquisition will be a license for inefficiency and will impose an unfair burden on small shareholders and investors.*

Second, mergers often increase competition, particularly in markets dominated by a few large firms where de novo entry is either too risky or expensive. In these markets, mergers represent the most likely source of increased competition. Prohibiting these mergers will shield dominant companies from new competition.

Third, mergers often achieve economies of scale and other synergies in management, product development, promotion, research and development, and marketing. These efficiencies help provide U.S. consumers with products of quality at the lowest price. Prohibiting such mergers will mean higher prices and less innovation.

Fourth, mergers often provide efficiencies in capital allocation which increase the ability of small and moderate-size companies to raise needed funds at reasonable prices. Prohibiting such mergers will impair the ability of such companies to modernize their operations and will increase the possibility of unnecessary plant closings and bankruptcies.

Fifth, mergers often enhance the stability of both the acquired and acquiring companies through diversification and distribution of risk. Such stability provides added security not only to the company's shareholders but to the employees, suppliers, and communities which depend on a company for their life's blood. Prohibiting such mergers will mean destabilizing enterprises of vital importance to this country and local communities.

---

*The unfair penalty which a merger ban would inflict upon shareholders and investors has been described by Margaret Sullivan, President of the Stockholders of America, Inc., and Michael Bell, Executive Secretary of the National Venture Capital Association. See Statements and Testimony of Margaret Sullivan (May 17, 1979), Michael Bell (May 17, 1979), Hearings on S.600.

Sixth, mergers often provide the only rational option for companies that wish to sell out their assets without going through a disruptive liquidation. The undervalued stock market will not pay a price approximating economic value to such firms and merger is often the only attractive alternative.

Seventh, by impeding the natural process through which capital is reallocated in the economy, there is a risk of freezing the ranks of the largest companies and decreasing overall investment in the economy.

Finally, anti-merger proposals would give foreign competitors a still-greater unfair advantage over domestic firms. U.S. companies face stiff competition both at home and abroad from foreign firms which often enjoy substantial advantages in the form of government subsidies, access to inexpensive labor, and reduced regulatory costs. The only way in which U.S. firms can successfully compete with these ever growing foreign companies and provide jobs for the American people is by continuing to maximize American efficiency and innovativeness and offering superior products at low prices.

Anti-merger proposals, however, by reducing the ability of U.S. firms to achieve their optimal level of performance, would seriously handicap these firms in their competition with foreign industrial giants.* Our balance of payments and employment would suffer and yet another obstacle would be placed in the way of U.S. economic growth and progress.

In sum, the only credible evidence that exists shows that new anti-merger legislation will provide few, if any, benefits and that it will impose substantial new costs on society.

CONCLUSION

The business community recognizes that a great deal remains to be learned about the causes and effects of merger activity and wants to cooperate with this Subcommittee in responsibly investigating these issues. Objective research concerning the causes, costs and benefits of merger activity should be given top priority, and business intends to do its share in providing sponsorship for such research.

---

*See, e.g., Statements and Testimony of Senator Adlai Stevenson, Jr. (April 25, 1979), Professor Kenneth W. Dam (April 25, 1979), Professor Yale Brozen (April 25, 1979), Professor Jesse W. Markham (April 25, 1979), Professor J. Fred Weston (April 25, 1979), Hearings on S.600.

APPENDIX PP.—STATEMENT OF THE CHAMBER OF COMMERCE ON CONGLOMERATE MERGERS

CONTENTS-TABLES-CHARTS

STATEMENT ON CONGLOMERATE MERGERS
CHAMBER OF COMMERCE OF THE UNITED STATES

FEBRUARY 25, 1980

Contents . . . Page

Introduction 1
    Merger Legislation Issue. 1
    Balancing Benefits. 2
    Statement Organization. 3

I. Efficiency Gains Result From Merger Activity. 7

II. There Are Existing Legal and Economic Limits on Conglomerate Growth 10

    Supermergers. 11

III. The "Muckraking" Motivations for Merger Activity Lack General Importance 13

IV. Firms Smaller Than the Largest 200 Are Playing an Increasing Role in the American Economy. 16

    Plant Closings. 20

V. Very Large Firms Center in a Few Specific Industries. . 23

VI. Aggregate Concentration is Without Value as a Guide to Policy 26

    1. The Apples and Oranges Problem. 27

    2. The Closed End Class Problem. 29

    3. The Relative Growth Problem 30

VII. Aggregate Concentration Has Not Been Measurably Affected By Mergers 32

VIII Antimerger Legislation Would Adversely Affect The Number and Growth of Smaller Corporations 40

    A. Antimerger Legislation Would Adversely Affect Incentives for Forming Smaller Firms 40

    B. Internal Growth by Large Firms, as an Alternative to Acquisitions, Would Reduce Small Business Opportunities. 41

IX. Size Based Merger Prohibition Would Not Protect Small Business. 45

    Predatory Pricing 47

Conclusion 51

Contents

Page

Appendix A, Manufacturing Establishments Going Out of Business in 1975 55

Appendix B, Manufacturing and Mining Acquisitions By Top 200 Manufacturing Corporations of 1975, 1961-76 -- Estimated Share of Corporate Manufacturing Assets Held by 200 Largest Manufacturing Corporations of 1975. 59

Tables

1. Manufacturing/Mining Corporations with Assets of $10 Million. 16
2. Trend, Number Business Corporations in U.S. 1958-75 . . 17
3. Aggregate Assets Active Corporations. 18
4. Non-Vanishing Independent American Manufacturing Corporation 19
5. *Fortune* 50 Largest Industrials By Assets, 1977. . . . 20
6. Industry Distribution, Assets Fortune Top 50 (1978) . . 23
7. Size Distribution, Largest 1000 Industrials, 1977 . . . 24
8. Share, Largest 200 Nonfinancial Corporations in Nonfinancial Assets 32
9. Share, Largest 200 Manufacturing Corporations in Manufacturing Value Added (Share of "all others") . . . 33
10. Share, Largest 200 Manufacturing Corporations in Manufacturing Assets (Share of "all others"). 34

STATEMENT
on
CONGLOMERATE MERGERS
for submission to the
SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE
of the
HOUSE COMMITTEE ON SMALL BUSINESS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Fred Byset*
FEBRUARY 25, 1980

The National Chamber appreciates the courtesy of the Subcommittee in offering this opportunity to express views on the effects of conglomerate mergers on local communities and small business. As the world's largest business federation -- composed of more than 88,000 business members, 2,600 chambers of commerce in the United States and abroad, and 1,300 trade associations -- we share the interest in and concern for the welfare of small business. In fact, small business is heavily represented in our membership; approximately 80% of our business members have fewer than 100 employees.

Others are showing similar interest and concern, especially academic experts. Some of these people are appearing as witnesses at this inquiry, and we are confident that they will contribute substantially to the Subcommittee's understanding of the issues involved.

Introduction

Merger Legislation Issue. Although this inquiry does not address a specific legislative proposal, it very likely follows from a perception that the country needs more legislation to restrict the merger activity of large corporations. Indeed, it would not be overly imaginative to think that a concept of possible legislation may already exist.* As we visualize it, the legislation could take the form of absolute prohibitions of mergers by firms of some fixed size. That is, it could be structured as a conclusive legal presumption that mergers meeting an arbitrary size criterion always have adverse effects.

---

* Associate Director, Government and Regulatory Affairs

Or, it could be designed as a presumption combined with illusory affirmative defenses. In that case, it would shift the traditional burden of proof from the government to the defending company. Instead of the government having to prove the illegality of a merger transaction because of likely harm to competition, the defendant would have to prove its propriety. For example, a merger involving a company of X dimension would be illegal automatically, unless the company could prove by clairvoyant evidence that substantial increases in competition or efficiency would result. A lack of harm to competition would not be enough to let the transaction go ahead.

Legislation of this nature, or any other, to restrict freedom of business association, is neither necessary nor desirable for promoting business competition, the policy goal of antitrust. Consequently, we would oppose measures to further circumscribe merger activity. If other goals -- social or political -- are contemplated, we say only that they would be inappropriate to antitrust and would in fact corrupt its utility as an economic instrument.

Balancing Benefits. Any assessment of proposals to restrict or prohibit large firm mergers and acquisitions requires a balancing of the

---

*See, for instance, S. 600, S. 1246, H.R. 3169, and H.R. 4295

(3)

immediate and tangible benefits to investors from such mergers against alleged benefits to small business and the public from prohibiting them. The direct benefit to stockholders of acquired companies, in the form of price premiums paid in excess of prices realizable by ordinary market sale, is at least 15% in the average merger. At present rates of merger activity, the resulting premiums are an appreciable part of total returns to investors.

The level of the Dow-Jones industrial average, as measured in constant dollars, has declined approximately 55% since 1965, and indeed some two-thirds of the stocks of Forbes' 1007 leading corporations have not recovered from the recession levels of 1974-1975, in constant dollars. In going through the 1978 Fortune Double 500 Directory, one finds few corporations which have achieved a return to investors over the 1967-77 period equal to the rate of inflation, let alone a return representing true interest on investment.

A disturbingly high percentage of publicly held corporations are valued by the securities markets below the book value of their assets. Apart from the unfairness of preventing investors from taking advantage of occasional opportunities to salvage what they can, antimerger legislation would generate the adverse consequences associated with delaying and distorting an obviously necessary adjustment process. Such legislation would injure both investors and the economy, and it would not benefit small business.

Statement Organization. More generally, purchases and sales of corporations, like other transactions of voluntary purchase and sale, occur bebause both buyers and sellers feel that they benefit from the transaction. These gains from trading are efficiency gains, analyzed briefly under Point I of this Statement.

Amended Section 7 of the Clayton Act already protects the public welfare from anticompetitive mergers and acquisitions. The energetic activities of the Federal Trade Commission and the Antitrust Division under Section 7 give assurance that large firm merger activity poses no reasonable probability of lessening competition. Existing limits, both legal and economic, on large firm mergers are further examined under Point II. Point III addresses some of the "muckraking" motivations sometimes attributed to merger activity.

The Statement next takes up the claim that "aggregate concentration" is increasing. It is sometimes said that this is something we should be concerned about -- so much so, that taking a supposed merger and acquisition component out of "aggregate concentration" is said to have sufficient societal value that to achieve it, advocates of new antimerger legislation are willing to deprive investors of several billion dollars a year in benefits, without any compensation whatever. The arguments advanced for such generosity with other people's rights and interests merit skeptical and critical scrutiny.

The next part of this Statement is such a scrutiny of aggregate concentration and the supposed link between it and the case for antimerger legislation. The main points are the following.

1. Firms of small to moderate size are not being absorbed into a few giant conglomerates; they have been growing steadily in numbers and aggregate size for many years. Point IV.

2. Very large firms center in a few specific industries. Point V. Modern economies are oriented to energy, transportation, communications, and chemistry. Few will be surprised to find that firms in these industries tend to be very large. Likewise, export trade in manufactured goods is predominantly a large firm activity; the largest 200 account for some 44%

of manufacturing value added and some 75% of exports. Changes in aggregate concentration (statistical problems aside) reflect mainly shifts in consumer demand to large-firm industries and the rising importance of export trade. The effect of merger and acquisition activity is not statistically measurable; proponents of antimerger legislation are reduced to arguing that aggregate concentration would have declined more than it did had there been no mergers.

3. As a guide to policy, "aggregate concentration" is useless because it lacks a point of reference: What should "aggregate concentration" be? Point VI. If we wish to increase our export trade and expand our production of energy, aggregate concentration should be higher than it is; if we wish to increase our production of food, clothing, and textiles, aggregate concentration should be lower than it is. If one wishes to know how "small" firms (or firms smaller than the largest 200) are doing, one must look at their figures on growth in numbers of firms, assets, and profits; one cannot tell how small firms are doing by looking at an aggregate concentration statistic which, essentially, compares the performance of certain industries to certain other industries, not the performance of large firms and small firms. Besides, mergers have not contributed measurably to concentration. Point VII.

4. Merger and acquisition activity operates as a positive incentive for entrepreneurs considering the formation of new enterprises; and the restriction of mergers and acquisitions would work against the interests and expectations of small firm entrepreneurs. Point VIII. Such restrictions would tend to increase aggregate concentration, both (a) by removing the incentive prospect of selling out to a large firm and (b) by redirecting large firm investment into alternative channels of "internal expansion" in ways contrary to the interests of small firms. The view sometimes

stated that large firms should be required to grow by "internal expansion" rather than by acquisitions rests on an inadequate comparison of the effects of the two lines of growth on small firms.

In Point IX, we illustrate that size-based merger prohibitions would not protect small business.

1. Efficiency Gains Result from Merger Activity.

The usual reason for business transactions is that both parties think they will benefit, and because of differences in their needs both parties to business transactions usually do benefit. This basic "miracle" of trade is what economic efficiency is all about, and it contains the short answer to the question, "Why do mergers occur?" They occur because the selling stockholders and the acquiring company both rightly expect to benefit. They may be persuaded partly by brokers working for their commissions and partly by ambitious executives; but it is still the stockholders who have to be "sold."

The more interesting question is why the selling stockholders and the acquiring company both expect to benefit. For the selling stockholders, the answer is usually easy; they are offered a premium over the existing market price. There is thus general agreement among economists who have studied mergers that they benefit the stockholders of the acquired company. There is only slightly less general agreement that mergers on average do not injure the acquiring company and may benefit it -- the gains offset the premium paid.* Since we are dealing with mergers which do not lessen competition in any line of commerce in any section of the country, the recoupment of the premium is presumptively due to efficiency gains, not to gains in monopoly power. Probably the four most common efficiency gains are the following:

---

*The studies are affected by the record of the go-go conglomerates of the 1960's; mixing their results as acquiring companies with the results of the more traditional diversifying mergers raises the average for some periods and lowers it for others.

(1) At present, it is cheaper to buy assets needed for expansion by buying a company than by buying the underlying assets directly. Buying needed real estate, plant, machinery, inventory, and even cash en bloc at a substantial discount is surely more efficient than paying inflated prices in ordinary markets.

(2) Usually, the acquiring company has some ideas for making the acquired business more productive through joint R&D, marketing or production arrangements with existing operations, or through needed infusions of new capital. These are evidently "efficiencies."

(3) Sometimes, there is an improved cash flow match, of the general sort described as follows by Professor Peter O. Steiner of the University of Michigan:

> "...General Dynamics (GD) with large aerospace and other contracts, was short of cash in a very tight capital market. United Electric Coal Companies (UEC) was receiving a large cash flow from its long-term contracts selling coal to electrical utilities. Most of UEC's existing reserves were already being mined for delivery to particular utility plants under long-term contracts. Because UEC was finding it impossible to acquire suitable additional strip coal mining reserves in its area of operation, the company was faced with the following choices: paying large cash dividends to its stockholders; seeking coal reserves in new areas (e.g., Wyoming) at a higher cost and out of its area of market contacts; entering new ventures for which it lacked know-how and personnel; or being acquired by a company that valued its cash flow very highly. Its principal stockholders preferred the last alternative, and it seems likely that they maximized their return by this choice." Peter O. Steiner, Mergers (Ann Arbor: University of Michigan Press, 1975) 79, n.4.

This procurement of needed cash flow at less than the cost of obtaining it in conventional capital markets is evidently an "efficiency."

(4) Sometimes, an acquisition has tax advantages, usually in the form of providing positive earnings to offset a tax loss carryforward. Not letting a tax loss carryforward go to waste is certainly a private efficiency; whether it is a social efficiency depends on one's opinion of the social utility of financing increased Government spending.

One suspects that if Congress could find a way to increas returns to beef producers without increasing costs to consumers, the discovery would be regarded as a major "efficiency" innovation. Mergers are not essentially different. What they do is to increase returns to investors without imposing additional costs on consumers:

(1) Buying assets cheap adds no costs to consumers.

(2) Joint operations and new captial add no costs to consumers.

(3) Improving cash flow at a lower cost than by borrowing from banks adds no costs to consumers.

(4) Savings taxes adds no costs to consumers.

What makes an affirmative efficiency defense anomalous is that a merger in which the acquiring company expects to get its bait back after it has paid a premium for the acquired company must, in the "mind" of the acquiring company, involve efficiencies. But to require proof that it "will" produce efficiencies writes the normal elements of business risk out of the statute -- after Penn Central, who knows? In the end, conditioning a merger transaction on having the staff of the FTC or Antitrust Division second guess the efficiencies prediction of people who are putting their money on the line for the proposition that there are efficiencies would be an uneconomic expansion in the role of the antitrust bar, both Government and private.

II. There Are Existing Legal and Economic Limits on Conglomerate Growth.

There are both legal and business limits on the growth of any one corporation by the conglomerate merger route.

Legal Limits.--Existing Section 7 of the Clayton Act, prohibiting as it does most horizontal and vertical mergers, means that after a company has consummated a series of conglomerate mergers, it faces a shrinking market, with declining possibilities for expanding further without running into Section 7 roadblocks established by past acquisitions. In practice, these legal limits interact with the business limits considered below, and it is difficult to estimate the effect of the legal limits considered by themselves. But we do know that only one conglomerate achieved membership in the over-$10 billion size class (ITT), and its assets are inflated by financial assets of insurance companies and by substantial overseas investments. Also, it has experienced at least its share of internal growth.

Business Limits.--Expansion by merger is attractive when existing businesses do not meet discounted cash flow tests for new investment, and by definition what one tries to find are businesses that do meet such tests. A successful acquisition program will presently provide a corporation with internal investment opportunities sufficient to absorb available cash flow. At that point, expansion by acquisition ceases to be interesting; what sometimes happens, in fact, is that the internal cash needs bloom unexpectedly fast and some acquisitions have to be sold off.

Similarly, the tax loss motive for acquisition activity is limited by the size of the tax loss and disappears as the loss is used up.

Supermergers.--Historically, mergers between multibillion dollar industrial companies have been very rare. Since 1969, only two mergers have been consummated in the manufacturing sector where the acquired assets exceeded $1 billion. In one -- General Electric's acquisition of Utah International ($1,130.8 billion) -- most of the acquired assets were foreign assets. Also, General Electric had recorded an offsetting divestiture of $547.7 million in 1970 (sale of computer business componants to Honeywell). The other -- Atlantic Richfield's acquisition of Anaconda ($2050.9 million) -- was challenged by the Federal Trade Commission under existing law, by complaint issued October 13, 1976, Docket D-9089.*

For 1978, *Forbes* (January 8, 1979, p. 242) listed three "super deals": Borg-Warner/Firestone, Chessie/Seaboard Coastline, and Occidental Petroleum/Mead. The second is subject to Government review through the ICC, and the first and third have since been abandoned.

The merger wave of 1967-1969 produced three over-$1 billion industrial acquisitions -- Atlantic Richfield's acquisition of Sinclair and the two steel acquisitions (Lykes/Youngstown Sheet & Tube and LTV/Jones & Laughlin).

The largest industrial acquisition prior to 1968 was McDonnell's acquisition of Douglas Aircraft. This is an unhappy reminder that the public

---

*We have drawn on the list of over-$100 million mergers in Appendix Table 10 of Professor W. F. Mueller's *The Celler Kefauver Act: The First 27 Years* (Washington: Government Printing Office, 1978). This table is not headed in such a way as to limit it to industrial acquisitions, and it contains reference to a Rapid American/Glen Alden acquisition which others put in retailing. But we infer from the omission of Penn-Central and Marcor that the industrial limitation was probably intended.

interest may sometimes be very well served by a very large merger. A statutory proclamation, "Never over $2-Billion!" will be viewed by the superstitious as an almost sure guarantee that before long we will be wryly adding, "Well, hardly ever."

There have, of course, been some very large acquisitions not involving industrial corporations. The Penn-Central merger-disaster is one; it was, however, within ICC jurisdiction. Mobil's acquisition of Marcor involved a retail chain which had made the strategically fatal mistake of betting against the future of the American economy immediately after World War II, and its acquisition by Mobil may very well turn out to be procompetitive.

Overall, it seems safe to say that for at least the last forty years super-mergers have played a negligible part in shaping the structure of our $4 trillion American economy, either in terms of market concentration or in terms of aggregate concentration. To legislate in advance against events which occur this rarely -- and which are inevitably highly publicized and registered in advance with FTC when they do occur -- is simply unwise. What is almost sure to happen is that when the event does occur, it will not be something born of managerial empire building, but of clear necessity, and the law will be discredited as a dogmatic obstacle to a sensible solution to a king-size headache.

III. The "Muckraking" Motivations for Merger Activity Lack General Importance.

The principal "muckraking" motives said to lie behind merger activity are (1) mangerial ambition, (2) accounting gimmicks, and (3) tax gimmicks.

In a reasonably well-designed corporation, the personal ambitions of managers will parallel the interests of stockholders. Securities markets properly attach importance to corporate growth in sales, market share, and earnings; and if stockholders find themselves with an incumbent management which does not share this interest in growth, they may well need new management. Investors get returns from dividends paid out and from changes in securities market evaluation of their holdings; book profits have only so much significance as the market gives them, and in a company that seems to be going nowhere, that significance is likely to be small. So long as the owners of corporations benefit from growth, they will surely structure management compensation systems so that managers also benefit from growth -- even if this permits the muckrakers to proclaim that the "real" reason for acquisitions is managerial ambition.

The accounting problems we leave to the SEC, the Accounting Principles Board, and the rising sophistication of securities analysts. We doubt that accounting gimmicks play more than an occasional part in present merger activity; there are those who claim that present accounting practices are if anything an obstacle.

The tax incentives for mergers were carefully reviewed by Peter O. Steiner in Chapter 4 of Mergers (Ann Arbor: University of Michigan Press, 1975). He makes several points of interest.

1. The business choice is between capital investment in internal expansion and capital investment in acquisition. There is no tax incentive for selecting acquisition over internal expansion. In fact, an acquisition presents a tax dilemma not present in internal expansion: If the transaction is tax free to stockholders of the acquired company, the acquiring company takes the assets of the acquired company at the latter company's book value for tax purposes and gets a depreciation deduction only on that value. Internal expansion does not present this dilemma; the stockholders of the expanding company pay no tax, and the acquired assets are depreciable at current cost, often at accelerated depreciation rates.

2. A tax loss carryover is of no value without net income against which to offset the loss. Hence a corporation with low earnings or continuing losses and a large loss carryforward may seek to save something for its stockholders by acquiring, or getting itself acquired by, a corporation with substantial net income.

It may seem anomalous that tax loss carryovers are saleable only in the form of a corporate merger; but then again it may not be a bad idea, from the viewpoint of employees and other interested parties, to condition a transfer of a loss carryover on a transfer of the whole enterprise to a more viable corporation. Professor Steiner mentions how Textron, with accumulated losses in the textile business, parlayed the losses into a very successful conglomerate by acquiring a number of companies with high earnings. (At page 85.) But the fact that an occasional losing company, under an especially competent executive, makes an unexpectedly vigorous recovery is unlikely to lead to a change in the present tax treatment of loss carryovers, since in the usual case the present tax law seems merciful, if not coldly logical.

3. The merger wave of the late 1960's produced some "funny money" securities, such as the convertible debentures which lost most of their attractiveness with the Tax Reform Act of 1969. To the extent that the tax laws played a part in the design of these securities, the tax laws may have contributed to the rise of the go-go conglomerates. It is not believed that this combination of tax advantages and imaginative design of security instruments is playing any appreciable part in today's market for corporate control.

Professor Steiner's conclusion was that the view of the FTC and others who attach importance to taxation as a motive for mergers is based on the wrong answer to the old question, "Compared to what?" If a corporation has excess cash, there is certainly a tax advantage to acquisitions as compared to paying out the excess in dividends or buying up outstanding stock; but there is no tax advantage as compared to internal expansion -- in fact, there may be some slight bias against acquisitions.

A somewhat melodramatic view of the world, complete with virtuous heroes, imperilled heroines, and deep-dyed villains seems necessary to modern journalism; and the muckraking motivations attributed to management of acquiring companies serve the dramatic purpose of casting them in the villain role. Unfortunately, a reasonable regard for truth spoils the story line of our breakfast fiction; the business world is seldom very melodramatic.

IV. Firms Smaller Than the Largest 200 Are Playing an Increasing Part In The American Economy.

Most Americans prefer an economy that includes many firms of small or moderate size, and many are concerned by newspaper headlines reporting the daily disappearance of small firms into much larger acquiring corporations. Fortuntely, what the headlines report is "man-bites-dog" news, not the commonplace trend of real life.

The following table shows one careful estimate of the rise in the number of manufacturing and mining corporations with assets of $10 million and over. It gives a good indication of the trend in numbers of firms which, for manufacturing, are relatively small.

Table 1.

Year	Number of Companies
1961	2100
1962	2178
1963	2244
1964	2307
1965	2403
1966	2518
1967	2659
1968	2646
1969	2802
1970	2930
1971	2962
1974	3843
1978	4499

SOURCES: For 1961-1971, Peter O. Steiner, Mergers (Ann Arbor: University of Michigan Press, 1975) Table II-2, page 292; for 1974 and 1978, QFR data.*

A second way of evaluating the increase in the number of substantial companies is to examine the Fortune Double 500 list. In 1947, a corporation with sales of $307 million annually was one of the 50 largest (as measured by sales) in the United States. In 1977, there were 520 corporations with $306 million or more in sales in manufacturing industry. A corporation with just over $89 million in sales was one of the top 200 of 1947; in 1977, $89 million in sales was not enough to make the list of the top 1000.

---

*Quarterly Financial Report

In Table 2, we find a rising trend in the number of corporations with assets of less than $10 million, with assets of more than $10 million, and in either or both the manufacturing sector and the all industries sector.

Table 2.

Number of Corporations

Year	Manufacturing and Mining		All Industries	
	Under $10 Millions	Over $10 Millions	Under $10 Million	Over $10 Million
1958	154,224	2,278	918,211	9,424
1972	198,723	3,784	1,791,339	21,431
1975	228,036	4,439	1,996,863	24,915

The data in Table 2 is based on IRS returns, and since not all enterprises file consolidated returns for both parent and all subsidiary corporations, the numbers may be somewhat high. As a check, it may be noted that IRS data showed 4439 mining and manufacturing corporations with assets over $10 million for 1975, while QFR data show 3843 for 1974 and 4499 for 1978.

The number of corporations on either side of the $10 million breaking point has evidently been rising. How about their aggregate assets? The data are in Table 3.

Table 3.

Aggregate Assets of All Active Corporations, in Billions of Dollars

Year	Under $1 Million	$1-$10 Million	$10-$100 Million
1950	67	100	127
1955	92	136	183
1960	134	159	242
1965	171	206	318
1970	210	240	433
1974	247	306	573

Table 4, "The Non-Vanishing Independent American Manufacturing Corporation," makes use of data from Table 951, p. 578 of the 1978 Statistical Abstract to show the experience of the 1970's. Manufacturing corporations in various size classes are increasing both in number and in total assets and total profits. From these data we calculated the rate of profits as profits/assets, producing the interesting result that in the 1970-1977 period, the greatest rate of profit improvement occurred in the size class of smallest manufacturing firms -- under $10 million in assets. The rate of profit improvement in the over-$1 billion size class is a little below average. On the ordinary economic principle that growth will occur where the profits are, the future of relatively small manufacturing firms does not seem immediately threatened.

Table 4.

The Non-Vanishing Independent

American Manufacturing Corporation

Year	Asset Size Classification Under $10 Million	$10-$25 Million	$25-$50 Million	$50-$100 Million	$100-$250 Million	$250-$1000 Million	Over $1 Billion
Number of Corporations:							
1970	195,000	1,202	533	366	289	218	102
1975	NA	1,750	705	450	392	276	151
1976	NA	NA	757	472	400	301	162
1977	NA	NA	809	501	409	327	174
Aggregate Assets by Size Class, in $ millions							
1970	69,101	20,471	20,138	25,946	47,783	112,475	282,320
1975	98,147	31,307	24,720	31,395	62,524	139.113	423,705
1976	98,355	32,244	26,538	32,970	62,633	149,412	481,709
1977	102,111	35,603	28,595	35,032	63,418	161,655	529,108
Profits by Size Class, in $ millions							
1970	2,812	811	836	1,101	2,315	5,862	14,832
1975	6,212	1,831	1,327	1,676	3,553	8,165	26,370
1976	7,799	2,238	1,714	2,070	3,945	10,422	36,330
1977	8,680	2,189	1,867	2,252	4,397	11,290	39,793
Profits as a Percentage of Assets							
1970	4.07	3.96	4.15	4.24	4.84	5.21	5.25
1975	6.33	5.85	5.37	5.34	5.68	5.87	6.22
1976	7.93	6.94	6.46	6.28	6.30	6.98	7.54
1977	8.50	6.15	6.53	6.43	6.93	6.98	7.52
Ratio of 1977 Profit Percentage to 1970 Profit Percentage							
-	2.09	1.55	1.57	1.52	1.43	1.34	1.43

Although there are many in government who frequently express concern about the welfare of the moderate-size to small firms in the economy, accurate, up-to-date information about their welfare is surprisingly hard to find. The IRS series from which the tables were constructed is not completely up-to-date, and the Federal Trade Commission QFR series does not give the number of firms with assets of less than $10 million. It is apparent from the data that is available that the headline picture of our economy disappearing into a few giant conglomerates is the reverse of what is going on*; but what seems truly remarkable is that concern over the possible disappearance of small business has so far not resulted in a systematic Government effort to keep track of the facts about it.

Plant Closings. -- The United States has a highly competitive -- and therefore a highly turbulent -- economy. Two members of the staff of the Small Business Administration recently published an article in which they estimated that 500,000 new firms are started every year in this country -- and that 400,000 disappear.*

Census has furnished some unpublished data on the problem of plant closings, restricted to the recession years 1974-1975, and attached hereto as Appendix A. There was a decline of 1,496,500 jobs in manufacturing from 1974-1975, and the number of jobs, as of 1974, in manufacturing establishments that went out of business in 1975 was 479,200. On an all-manufacturing employment base, these 479,200 jobs represented 2.6% of 1974 manufacturing employment.

---

*An illustration of the headline mind at work is to be found in an article reprinted at page 520-521 of last summer's hearings of the Subcommittee on Antitrust and Monopoly on "Acquisitions and Mergers by Conglomerates of Unrelated Businesses." The article, "Merging of the 'Fortune 500,'" visualized a day when Fortune could find only 495 corporations suitable for its 500 list, and was accepted for publication in New York Magazine.

*Pat L. Burr and Richard J. Heckman, "Why So Many Small Businesses Flop--And Some Succeed," 16 Across the Board No. 2 (February, 1979) 46.

Industries which lost more than the average 2.6% of their employees due to plant shutdowns included the following:

Tobacco products	3.1%
Textile mill products	3.3
Apparel	6.4
Lumber & Wood products	5.1
Furniture & Fixtures	4.0
Printing & Publishing	3.0
Leather, Leather Products	4.2
Stone, Clay, Glass Products	2.8
Miscellaneous Manufacture	4.3

For the industries most heavily represented among the 200 largest companies, the corresponding percentages were:

Chemicals	1.1%
Petroleum & Coal	0.7
Rubber	2.2
Primary Metals	1.1
Electrical, Electronic	1.6
Transportation Equipment	1.3

In terms of plant size, 97% of the shutdowns, in terms of number of plants closed, and 58% in terms of employees, involved plants with fewer than 100 employees -- i.e., small business. Of 27,957 plant closings, 225 involved establishments with more than 250 employees each. These over-250 employee closings involved 107,800 employees, or an average of 479 employees each.

Appendix A does not include data on the total number of plants and employees in the different establishment size classes for 1974, but the Statistical Abstract, 1978, has figures at p. 809 for 1972. Since the figures were not changing much, it is reasonably safe to use them for the purpose of making sure that the greater number of closings in small establishments is something more than a simple reflection of the greater number of small plants as compared to large. Establishments with under

20 employees accounted for 65% of the number of establishments and 6.2% of the number of employees (in 1972).* Plant closings for this under-20 employee group in 1975 accounted for 82% of the number of closed establishments and 23% of the number of employees affected.

Conversely, the over-250 group accounted for 4.4% of establishments and 57.3% of employees in 1972, as compared to 1% of plant closings and 22% of the affected employees in 1975.

Both from the size distribution of plants involved in plant closings and from the distribution of plant closings among industries, it seems evident that plant closings are predominantly a small business problem. Obviously, neither large corporations nor small business shuts down a plant because it wants to; a shutdown is a frustrating defeat irrespective of size. We are probably looking at an "infant mortality" problem; small size is a proxy for firms that fail to become established and grow into more substantial enterprises. Given time, Census could produce more data, but more data seem unlikely to alter the obvious conclusion that if plants were more often small and locally owned, they would be shut down more frequently. The plant closing hazard, with its associated social losses, increases as plant size goes down.

---

*The small percentage of manufacturing employment in small establishments may come as a surprise to those enured to claims that small business accounts for most new jobs in the private sector. The claim rests on the shift of private sector employment from manufacturing to services. Within the manufacturing sector, it does not hold.

V. Very Large Firms Center in a Few Specific Industries.

Table 5 (attached) is a list of the 50 largest industrials on Fortune's 500 list. The Fortune list is arranged in order of sales, and the Table 5 list has been rearranged in order of assets.

The reason for giving special attention to the top 50 is simple: Of a total of $873 billion in assets of Fortune's 1000 largest companies, these 50 have $418 billion, or 48% of the total.

These firms center in the petroleum, automobile, chemical, electrical equipment, and steel industries, as shown on the follow Table 6:

Table 6.

Industry Distribution Of
Assets of 1978 Fortune Top 50

Industry	Assets in $ Millions	% of Total
Petroleum	188,519	45.02
Automobiles	53,567	12.79
Chemicals	40,799	9.74
Electricals	29,453	7.03
Steel	14,813	3.54
Multicompanies	32,163	7.68
All Others	59,472	14.20
		100.00

The five industries listed ahead of "multicompanies" have 78.12% of the assets of the top 50. The same five industries supply some 40 or more of the world's largest 50 companies. The "All Other" industries include computers, paper, tractors, farm machinery, tires, and aluminum -- along with the ubiquitous office copier. The figures for computers and office copiers are, however, somewhat misleading because of the industry practice of leasing -- what other industries would count as sales turn up as assets in a leasing business, in the form of an inventory of leased equipment.

Fortune's Double 500 Directory of the largest industrials lists manufacturing and mining companies in order of size by sales. In order to develop the following table of size distribution, 47 firms which were in the top 500 by sales but not by assets had to be reassigned to the second 500, with a corresponding shift from the second 500 by sales to the first 500 by assets. There is probably a similar adjustment to be made in the 9th and 10th deciles of Table 7, but the data are not available.

Table 7.

Size Distribution of Largest 1000

Industrials, 1977

(1) Decile	(2) Assets $ Million	(3) Cumulative Assets	(4) Percent of Top 1000	(5) Cumulative Percent	(6) Rate of Size Increase
1-100	536,155	536,155	61.40	61.40	1.393248
101-200	134,397	670,552	15.39	76.87	.652189
201-300	70,157	740,709	8.03	84.82	.504088
301-400	42,433	783,142	4.86	89.68	.401678
401-500	28,419	811,561	3.25	92.93	.380148
501-600	19,446	831,007	2.23	95.16	.194688
601-700	16,009	847,016	1.83	96.99	.332058
701-800	11,492	858,508	1.32	98.31	.270348
801-900	8,773	867,281	1.00	99.32	.384168
901-1000	5,979	873,260	0.68	100.00	.051128 (Note A)

Note A: Column (6) gives the compound growth rate in firm size required to get to the average size firm in each row from the average size firm in the row below. It is the interest rate computed from a compound interest program, using the entry in column (2) as future value, the entry below as present value, and the number of periods as 100; and it indicates the average difference in size between adjacent firms. For the last row, future value is $59,790,000, present value is $10,000,000, and number of periods (i.e., firms) is 1,499. The rise in size from $10,000,000 to the largest 1000 is even flatter if one uses the asset size of No.1000, American Beef Packers, of Oakland, Iowa, with sales of $273,792,000 and assets of $13,623,000. As it is, if firms smaller than the largest 1000 are arranged in order of asset size, any given firm will find almost 20 firms on either side within 1% of it in size.

It is apparent that the size of firms increases very slowly over the 3500 firms with assets between $10 million and the average of the lowest decile of the largest 1000 -- $59,790,000. The rate of increase is noticeably higher in the top 1000, but still not very impressive until one reaches the top 100 or 200. And when one does get "where the concentration is," it turns out to be principally a matter of industries where firms come in large sizes.

VI. "Aggregate Concentration" Is Without Value as a Guide to Policy.

The concept of aggregate concentration, as it is usually used, has two fundamental weaknesses.

The first is that the concept is ordinarily applied only to the manufacturing sector of the economy, or to manufacturing and mining. In reality, manufacturing is only about a quarter of the economy, whether measured by employment, assets, value added, or revenues. It is also the sector where, mass production being what it is, social critics could best expect to find dominance by large firms. But in terms of a public policy favorable to the growth and development of numerous independent small businesses and also favorable to the growth and development of an efficient modern economy, it is on the whole desirable that large firms and small firms are found in different competitive subdivisions of the economy -- that we do not, in general, find elephants dancing among the chickens. Nor need we have much patience with a kind of forensic economics which finds it surprising that in the elephant preserve, the elephants outweigh the chickens. (In reality, a surprising amount of manufacturing value added still comes from small-to-moderate size firms, especially when one gets outside the sector of manufacturing devoted to energy, transportation, communications, and chemistry.)

The broader fundamental weakness with "aggregate concentration" is that whether it is applied only to manufacturing or more broadly to other sectors as well, it does not include any standard of reference as to what "aggregate concentration" should be. Business lives in a competitive environment, and by analogy to the biosystem one would expect the small firms to outnumber the large firms, but whether the small firms should (in total) be expected to outweigh the large firms (in total), or what difference it makes whether they do or not, are questions left open by the "aggregate concentration" concept.

We know of no way to supply the missing standard of reference.

There are other flaws in the "aggregate concentration" concept.

1. The Apples and Oranges Problem.--The usual aggregate concentration figures for manufacturing, published by the Census and appearing as Tables Nos. 946, 947, and 1423 in the 1978 Statistical Abstract, show relatively small, undramatic movements in the percentage of assets held by the largest manufacturing corporations, as well as in value added, sales, and employment. In assets, the 200 largest reached a high point of 60.8% in 1968, fell to 56.7% in 1974, and went back to 58.4% in 1977.

Trying to identify trends, or to pick out relationships between aggregate concentration and merger movements, is complicated by the difficulty of confining both the numerator and the denominator of aggregate concentration ratio data to domestic manufacturing assets. As foreign trade has grown, large corporations have increasingly participated in foreign trade, which means investing overseas. Similarly, as growth in manufacturing has lagged growth in services and other sectors of the economy, manufacturing companies have invested in the other, faster-growing sectors. Beginning in 1973, the FTC has sought to eliminate foreign assets from the ACR, but the data are still heavily distorted by large firm investment in nonmanufacturing assets, typified by the Alaska Pipeline and Marcor.

Former Attorney General John N. Mitchell seems to have originated a more spectacular aggregate concentration statistic -- the ratio of the total assets of Fortune's largest 500 industrials to manufacturing assets.*

In testimony before the Senate Subcommittee on Antitrust and Monopoly July 27, 1978, Chairman Michael Pertschuk of the Federal Trade Commission submitted a chart based on the Mitchell precedent, presenting the total assets of Fortune's 500 largest industrials as a percent of manufacturing assets, apparently determined from FTC QFR reports. By his end-of-1977 figures, Chairman Pertschuk had the Mitchell Statistic up from 75 percent to 83 percent.

The 1977 assets of Fortune's largest 200, from Table 7 above, were $670,552 million. Dividing this sum by the Census 58.4% aggregate concentration ratio for the largest 200 and multiplying the result by 100 would give total manufacturing assets of $1,148,205 million. Back to Table 7, the total assets of the Fortune 500 are $811,561 million, which, being divided by total manufacturing assets of $1,148,205 million, gives an aggregate concentration ratio for the largest 500 of 70.68%, not 83%.

Of course the problem is the contamination of the total assets of Fortune's 500 largest industrials with a good many things besides manufacturing assets. The total assets of Fortune's 500 largest industrials are not a portion of the total manufacturing assets of the United States; and it is no more legitimate to speak of the total assets of the 500 as a portion of the total of United States manufacturing assets than it is to speak of 500 apples as a portion of 1000 oranges.* The Mitchell-Pertschuk statistic is simply one more example of political rhetoric which, in a just world, would do its users more harm than its victims.*

---

*In a speech to an audience in Savannah, Georgia, on June 6, 1969, where he said, "In 1948, the nation's 200 largest industrial corporations controlled 48 percent of manufacturing assets. Today, these firms control 58 percent (note that 10 years later, they still do), while the top 500 firms control 75 percent of these assets." (Emphasis supplied.)

2. The Closed End Class Problem.--Most economists are of the opinion that as firms grow to very large size, they reach a point where their rate of growth starts to decline. Since statistics showing increases in aggregate concentration imply that large firms are growing faster than small firms, they are likely to be received with some skepticism. The merger explanation won't do the trick; there is no reason to think that fast-growing firms outside the 200 largest use the merger route less than the 200 largest, though to test this point one would have to compare the growth rate of, say, the largest 1000 to that of the largest 200.

In any case, if the average size of the 200 largest corporations were growing at exactly the same rate as the size of "all other" corporations, aggregate concentration would rise. The reason is that the growth of the two size classes is an average; in each class, some firms grow more, and some grow less, than the average. But in the neighborhood of the 200th firm, the members of the largest 200 that grow less than average are replaced by members of "all others" who grow by more than the average.

---

*The division of the assets of Fortune's 200 largest by 58.4 is also not a legitimate way to generate an accurate statistic; it is, however, defensible as a way of testing apples and oranges ratios.

*Chairman Pertschuk had another chart showing the steady rise in the percentage of manufacturing assets held by firms with assets of $10 million or more -- a chart which rather neatly tracks the way inflation moves firms of a given real size from the under-$10 million to the over $10 million size class. The charts are in the printed volume of last summer's hearings, pp. 160-161.

The result is an increase in the share of the largest 200, even with identical growth rates in the two groups -- the largest 200 and "all others." This effect can be substantial, since the most successful members of "all others" do not necessarily enter, or stay, in the sizes near the 200th firm.

3. The Relative Growth Problem. -- The other explanation of a rise in aggregate concentration, contrary to the received wisdom that large firms grow more slowly than small firms, is that the aggregate concentration ratio does not really measure differences in growth rates of firms, but of industries. An increase in "aggregate concentration" usually means nothing more than an above-average growth rate in petroleum, automobiles, chemicals, electrical equipment, or steel; and if these are the products that consumers are demanding, there is certainly nothing objectionable about growth in the industries that produce them.

Economists testifying both for and against merger legislation in the Senate last year have made the common mistake of assuming that there is some connection between aggregate concentration and market concentration. In an expanding economy, one would expect market concentration to decline; and proponents of anti-merger legislation have thought it strange that aggregate concentration has not declined with out expanding economy. There is nothing strange about it; so long as consumer demand for products of "large firm" industries rises faster than for other products, aggregate concentration will keep right on going up. This effect is reinforced by the McKinsey finding that exports are 75% a "largest 200" industry; the more we export, the more aggregate concentration will rise.

In the obvious absence of any standard of reference for what "aggregate concentration" ought to be, most public figures who use the term have tended to emphasize trends, rather than absolute levels, in the apparent belief that at least it ought not to be going up. But trends are no substitute for a reference point. A rising trend in aggregate concentration is entirely consistent with growth and prosperity of the "all other" firm sector or of the small firm sector. A rising trend carries no implication that small firms are being absorbed or displaced by large firms. All it suggests is that consumers are demanding more of the products of some specific, large firm industries, and that foreign trade is rising. The policy implications are, to say the least, elusive.

VII. Aggregate Concentration Has Not Been Measurably Affected By Mergers.

Preliminarily, we need to set out the aggregate concentration trends which have to be related to mergers -- on the intuitively plausible assumption that there is such a relationship.

In Senate testimony last year, Dr. Betty Bock of the Conference Board suggested that the most useful aggregate concentration figures would relate to the largest possible universe. We compromise with "largest possible" and start with nonfinancial assets:

Table 8.

Share of the Largest 200 Nonfinancial Corporations in Nonfinancial Assets

1958	41.1%
1963	40.5%
1967	41.2%
1972	39.9%
1975	39.5%

SOURCE: Statement of Alfred F. Dougherty, Jr., Director, FTC Bureau of Competition, dated March 8, 1979, before the Senate Committee on the Judiciary, p. 16.

Note: For 1975, aggregate concentration statistics limited to mining and manufacturing industries leave out of account $443 billion of assets in transportation and public utilities, $323 billion in wholesale and retail trade, and $90.5 billion in services. Statistical Abstract, 1978, Table 938, p. 572.

For purposed of confirming our expected impact of merger waves on aggregate concentration, the critical years are 1967-1969; 1968 and 1969 were both bigger years for mergers, as measured by assets, than 1967. For a hint that our expectations are in for trouble, note that aggregate concentration fell 1.3 points during the period that included 1968 and 1969.

Next, let us examine the manufacturing value added statistics -- the manufacturing data that is least contaminated with nonmanufacturing and foreign assets, and which has the further advantage of measuring size both in terms of employment and in terms of capital usage. Here, we have data back to 1947; and instead of leaving the experience of firms smaller than the largest 200 to inference, we can focus explicitly on their growth record.

Table 9.

Share of the Largest 200 Manufacturing Corporations in Manufacturing Value Added and Manufacturing Value Added Contributed by "All Others"

(1) Year	(2) Share of Top 200	(3) Total MVA*	(4) MVA From "All Others"*	(5) Growth in (4) Over Preceding Year**
1947	30%	74	51.8	-
1954	37%	117	73.7	42.3%
1958	38%	142	88.0	19.4%
1963	41%	192	113.3	28.8%
1967	42%	262	152.0	34.2%
1970	43%	300	171.0	12.5%
1972	43%	354	201.8	18.0%
1976	44%	511	235.1	16.9%

* Amounts in billions of dollars.

**For example, Manufacturing Value Added contributed by firms other than the 200 Largest increased by 42.3% between 1947 and 1954.

SIYRCE: For MVA, 1978 Statistical Abstract, Table 1401, p. 805; for column 2, Table 947, p. 576, except for the 1976 row, which is from Statement of John Shenefield before the Senate Judiciary Committee March 8, 1978, p. 8.

The largest increase in MVA took place between 1947 and 1954. This was a period of modest merger activity. It was also the period of the largest postwar increase in MVA contributed by firms other than the top 200 -- an increase of 42.3% in 1954 over 1947. This sharp rise in aggregate concentration is thought to have been associated with internal expansion from reinvestment of cash flow accumulated during the war years. MVA rose one point during the 1963-1967 period and another point during the 1967-1970 period. It rose more in the 1958-1963 period before the Great Merger Wave than it rose during the Wave. It has continued to edge up since the Wave ended in 1969.

Table 10.

Share of the Largest 200 Manufacturing Corporations in Manufacturing Assets and Manufacturing Assets Held by "All Others."

(1) Year	(2) Share of Top 200	(3) Total Mfg. Assets*	(4) Assets of "All Others"*	(5) Growth In (4)**
1965	56.7%	360,397	156,051	-
1969	60.1%	538,212	214,747	37.6%
1970	60.4%	574,200	227,383	5.9%
1971	61.0%	606,120	236,390	4.0%
1972	60.0%	656,719	262,680	11.1%
1973	56.9%	735,466	316,986	20.7%
1974	56.7%	843,897	365,407	15.3%
1975	57.5%	907,844	385,834	5.6%
1976	58.0%	994,951	417,879	8.3%

* Amounts in millions of dollars.

** See note to Table 9.

SOURCES: Column (2), 1978 Statistical Abstract Table 946, p. 576; Column (3), W. F. Mueller, "The Celler-Kefauver Act: The First 27 Years," (Washington: Government Printing Office, 1978), p. 124, Appendix Table A-1.

These figures show a 3.7% rise in aggregate concentration during the period of the merger wave, along with a record 37.6% rise in the assets of firms other than the largest 200. The trouble is that this was also a period of increasing overseas activity by American manufacturing firms, as well as a period when the non-manufacturing sectors were looking more and more attractive relative to manufacturing. When, in 1973, the FTC purged its concentration figures of overseas assets, aggregate concentration dropped back to its pre-merger-wave level. Also, it will be recalled that aggregate concentration as measured by nonfinancial assets did not increase during this period. It is at least possible that part of the apparent rise in manufacturing asset concentration was attributable to the acquisition by large manufacturing companies of nonmanufacturing assets--e.g., Commercial Credit and Hartford Fire. There is, in short, a little, but not much, in these figures to confirm our expectation that a merger wave must increase aggregate concentration.

There is another way of examining the role of mergers in changing aggregate concentration. The Statistical Abstract, 1978, Table 951, page 578, gives some information on the growth in assets for corporations with assets over $1 billion during the period 1970-1976. In 1976, 142 corporations with assets over $1 billion had total assets of $481,709 million. In 1970, 102 corporations with assets over $1 billion had total assets of $282,320 million. Well, we know that the 40 corporations which joined the billion dollar club between 1970 and 1976 cannot have had as much as $40 billion in assets in 1970; and that therefore the 142 of 1976 must have experienced growth of at least $481,709 - ($282,320 + 40,000) = $159,389 during this period. Professor Mueller has collected the mergers of the largest 200 corporations of 1975 for this period in Table Appendix A-1 (See note to Table 10 above), and they total $10,882 million for this period 1970-1976.

Dividing an overstated merger numerator (for 200, not 142, firms) by an understated denominator gives a maximum influence of mergers on growth of large manufacturing corporations equal to $10,882 ÷ 139,389 = 7.81%. Thus, a total prohibition on mergers during this period would have diverted 7.81% (at most) of the asset growth of the 1976 billion dollar club from external expansion to internal expansion. What the effect on aggregate concentration would have been is conjectural; as Lee Preston pointed out in a study for a different period, they might have grown more by internal expansion than they did by external expansion.*

---

*See Steiner's Mergers at 299-300. It is possible to argue that acquisitions of the largest 200 account for a higher percentage of the difference in their growth rate and the growth rate of "all others"; but even so the effect on the aggregate concentration ratio is miniscule.

Much of the belief that mergers have contributed to aggregate concentration arises from FTC calculations in "Economic Report on Corporate Mergers," published in 1969, in Table 3-10, page 190, "Assets Acquired by the 200 Largest Manufacturing Corporations of 1968 as a Percent of Total Manufacturing and Mining Assets, 1948-1968," Appendix Part 8A to Hearings Before the Senate Subcommittee on Antitrust and Monopoly, 91st Cong., 1st Sess. A similar table has recently been circulated in Professor W. F. Mueller's "The Celler-Kefauver Act: The First 27 Years," referred to above in the "Sources" for Table 10. A copy of this table is attached as Appendix D, for convenience of reference.

It will be observed that the percentages in column (5) are acquisitions (column 3) stated as percentages of total manufacturing assets for each year (column 4). Thus, since manufacturing assets are different numbers for each year, each figure in column 5 is a percentage of a different number; and by the ordinary rules of arithmetic addition of percentages of different numbers is not permitted.

Consequently, the 9.51% figure, presented at the foot of column 5 as 1961-76 "Acquisitions as percent of total," is a nonsense number, arrived at in violation of the principle that multiplication must precede addition.* Professor Mueller seems to have, however, a somewhat special interpretation of this nonsense number, stated at page 123 of his monograph:

> "The contribution of acquisitions to the growth of acquiring firms was estimated by assuming the acquired companies contributed to the acquiring firms' share of all manufacturing assets a percentage equal to the acquired assets' share of total manufacturing assets in the year of acquisition."

Turning back to column 5, it turns out that the odd mathematics are intended to embody the assumption that the acquisition of $1,638.2 million of assets in 1961 is enough to explain the presence of .0060 x $994,951 million, or $5969.7 million of assets, in 1976. Unfortunately, most corporate assets (unlike some agricultural assets) do not go forth and multiply spontaneously; rather, they depreciate and decay. To increase total manufacturing assets from $273,132 million in 1961 to $994,951 million in 1976, manufacturing corporations had to acquire $721,819 million in assets, plus replacements for the portion of the $273,132 million that wore out or otherwise went out of service. The sum of assets acquired by merger during 1961-1976 (column 3) is $45,913.2 million, which is 6.36% of the $721,819 million total growth from both internal and external expansion, without allowing for internal expansion in replacing acquired assets. Since the 200 largest grew from $139,646 million in 1960 to $610,900 million in 1976 (Appendix Table A-2), their growth was $471,254, of which their acquisitions by merger amounted to 9.74% (i.e., $45,913.2 ÷ 610,900).

---

*See, e.g., Israel H. Rose, Algebra: An Introduction to Finite Mathematics (New York: John Wiley & Sons, Inc., 1963) 35: "There is ambiguity in writing an expression like 7.10+4.10...What we intend it to mean is 70+40, or 110. It might, however, be taken to mean 7.(10+4).10, or 980. To avoid this possible misinterpretation, we agree that, in ambiguous situations, multiplication and division shall precede addition and subtraction." In Appendix Table A-1, converting percentages to decimals, column 5 and column 4 combine as .0060x273,132 + .0046 x 288,875 + .0060 x 304,877 +...+.0021 x 994,951; and adding the decimals simply makes no sense.

It is, of course, tempting to speculate on what the aggregate concentration ratio would have been had there been no mergers, or, to put the matter a little differently, what the share of the largest 200 of 1975 would have been had they made no acquisitions by merger after 1960. Professor Mueller speculates on this question by assuming that firms acquired by the largest 200 in 1961-1976 would have grown at the same rate as manufacturing industry as a whole if they had not been acquired -- i.e., that but for mergers one could climb into one's Packard, drive down to the station and get a train ticket from a General Electric computer, and board a Pullman drawn by a Baldwin locomotive for a trip on the Central of Georgia. An alternative interpretation of his assumption is that once a corporation acquires assets equal to, say, 10% of its total assets, thereafter all its growth is at least 10% growth by acquisition -- it can never grow by internal growth more than 90%. But this ignores the obvious fact that growth is a question of management decision and management competence; and once a merger has taken place, it is a question of the management decisions and competence of the acquiring firm, not of the acquired firm. As we noted above, business assets do not grow spontaneously.

Economists working without the bureaucratic presuppositions of the

Federal Trade Commission have generally concluded that merger and acquisition activity has had little effect on aggregate concentration. The leading investigators have included Betty Bock, Lee Preston, and Peter Steiner, and Professor Steiner summarized their work as follows in *Mergers*, at 289-301:

> "Although Bock and Preston put somewhat different glosses on their interpretations, it seems to me that they are both correct, and that each puts the factual picture in better perspective than the FTC report or the alarmist rhetoric. Clearly large firms do play a major role in American industry; clearly large firms grow both internally and by merger; clearly not all firms grow at the same rate and thus new and rapidly growing firms intrude into the list of largest companies displacing others that have grown less rapidly and replacing large firms that have disappeared. While mergers play a role in the activities of many large companies, they play on average a lesser role than other forms of growth." (At 300-301.)

On ordinary principles of economics, corporations may be expected to grow to the most efficient size and degree of diversification as a result of competition in both product and capital markets. This is a changing optimum, determined more from experiment than from theory; and without mergers and the efficiencies of mergers described above it is likely that corporations would be slower to reach the optimum and that they would spend more time at size levels different from the optimum. But with mergers accounting for less than a tenth of the stream of new assets into the largest corporations, it is difficult to believe that they change the outcome dictated by underlying economic forces by more than a very small amount; and on average the elimination of mergers would make it more, rather than less, difficult for market forces to take effect.

VIII. Antimerger Legislation Would Adversely Affect the Number and Growth of Smaller Corporations.

A. Antimerger Legislation Would Adversely Affect Incentives for Forming Smaller Firms.

The headline effect of each merger or acquisition is to reduce the number of companies by one. But public policy is not concerned with *a* merger. What is of policy concern are the costs and benefits of an active market for companies. The operations of such a market are an important element in ecnouraging the formation of new enterprises, and the rate of new enterprise formation, as we have seen, far exceeds the rate of company disappearance through acquisition or merger.

The incentive for forming new companies of any size is a dual profit incentive, composed of (a) operating profits and (b) profits from the eventual sale of the entrepreneur's interest in the company. This second incentive is particularly important for new company formation, because entrepreneurs are often less interested in staying with a business to earn routine long-term operating profits than in the creative work of establishing a new enterprise. A sharp reduction in the market for companies, whether based on the exclusion of holders of a high percentage of the assets of manufacturing (or other) companies from the market or on some other form of market restriction, would appreciably reduce this entrepreneurial incentive. The close tandem relationship between new company formation and the active merger market of the 1960's indicates how an active market for companies can encourage new company formation.

The number of mergers is small in relation to the number of companies existing and the number of companies formed each year; and a marginal change of incentives risks reductions off scale in relation to the number of mergers. Some 500,000 new businesses are formed each year. Using IRS data, there were, in 1975, 228,000 manufacturing and mining companies with assets under $10 million, and the number had been growing at the rate of 4340 a year since 1958. A slight change in the incentive structure, increasing the risks of entrepreneurship and reducing the rewards, could easily move the aggressive and ambitious business school graduate toward acceptance of managerial employment with a large company and away from the risks and pains of trying to start his own business.

B. "Internal Growth" by Large Firms, As An Alternative To Acquisitions, Would Reduce Small Business Opportunities.

At any given time there are bound to be some large corporations in mature businesses which generate more cash flow (profits and depreciation) than can be advantageously reinvested in the business. It is sometimes suggested that an argument for antimerger legislation is that these companies should be forced to spend their excess cash flow on internal expansion, rather than on the purchase of exising companies. The stated assumption is that "internal expansion" entails building needed new plant and equipment. The assumption is not correct.

Preliminarily, it may be desirable, if repetitive, to emphasize that in current business practice, new investment proposals are evaluated by estimating the net cash flow to be expected over the life of the investment, as much as one calculates the discounted present value of an annuity. If the investment exceeds its discounted present value, it should not be made. The rate of discount is also important. Using a rate of discount lower than the price/earnings ratio of outstanding equity securities could result in making an investment which would add less to the value of outstanding securities than the amount of the investment.

The discounted cash flow calculations for new plant and equipment would not be improved by antimerger legislation, and companies with excess cash flow would be more likely to turn to alternatives such as these:

(1) They would develop new organizational devices for entering new markets otherwise than by acquisition. What is mainly required is a longer planning horizon. Instead of making its decision to enter a new market after the market has become established, when risks can be further reduced by acquisition of a firm which has already learned the pitfalls, a diversifying firm could change its strategy to entering more numerous "infant" markets on a small scale early on. Later, the firm could settle on targets for large scale

expansion through its own outposts at roughly the same point in the maturing of a market where it might now consider an acquisition.*

This toehold or "stakeout" strategy would probably be a little more expensive for the diversifying company and would tend to discourage small firm entry into "stakeout" markets. The "stakeout" entry would say, in effect, "If this market develops into anything of any value, we will use our advantages of resources and experience to take it over." The effect on appraisal of small business prospects in such a market by both the entrepreneur and his investment backers could only be adverse, whereas the present acquisition activity has a positive incentive effect.

(2) Internal growth might take the form of vertical integration, either backward into component manufacture or forward into marketing. This might be a strategic error which would reduce the ability of the firm to adapt to future changes; but the cash generated by a firm's operations has to be invested somewhere, and considerations of risk and the limitations of the firm's knowledge base would suggest a preference for activities closest to its past experience -- i.e., parts manufacturing and marketing with which it is already at least partly familiar. In either instance, the effect of antimerger legislation would be to reduce business opportunities for smaller firms, thereby again discouraging their formation and even diminishing their prospects of survival.

---

*This is not, obviously, more than a conjecture as to how firms with excess cash would adapt to the need to find new ways to enter markets where entry by acquisition is foreclosed. Experience suggests that they would adapt somehow; and unfortunately the adaptation might very well not be an improvement, from the viewpoint of the interests of small firms, on the acquisition method.

(3) An even less palatable line of "internal expansion" might take the form of foreign investment. The elimination of domestic acquisition activity as a possible use of excess corporate funds moves foreign acquisitions or foreign construction of new plants or foreign marketing and promotional expenditures one step up the preference ladder.

(4) At hearings in 1978 before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, Professor W.F. Mueller gave an account of the expansion of Miller beer after its purchase by Phillip Morris. Probably, he intended the account as an argument against conglomerate acquisitions; but from the perspective of the small businessman the more serious threat is that antimerger legislation would force large companies with excess funds to use those funds for just such market-share-building programs as Professor Mueller described. For a company with the resources to blitz a market, an acquisition is at most a convenient preliminary step, not a necessity. These blitz campaigns are highly competitive and the outcome may very well be in the consumer interest, but the impact on aggregate concentration and the number of smaller firms is surely not what proponents of antimerger legislation would desire.

In short, "internal expansion" is not necessarily perferable to acquisition activity, from any viewpoint. The construction of new plant facilities, in preference to the purchase of old facilities through an acquisition, is something we like to see when it is the result of a free choice, because it is a sign of a healthy, growing economy. But trying to force construction of new plant which is not economically justified by depriving corporate management of any alternative is bad public policy. Management is not in fact deprived of all alternatives; and while it is a good thing that there are other alternatives, the truth is that most of them are a good deal less welcome than investment in acquisition.

IX. Size-Based Merger Prohibitions Would Not Protect Small Business.

Any active soliciting of small business support for size-based antimerger legislation raises a question as to how it would benefit small business. We have examined several possible answers.

(1) Since acquisition of firms under the ceiling size would not be prohibited, the legislation could not protect small firms from being bought out at premium prices by larger corporations. That small business would not welcome such protection seems obvious.

(2) An alternative possibility is that size-based legislation would protect small business against competition from large corporations which enter a small firm industry by the merger route. But this also seems untenable.

(i) Size-based legislation could not prevent large corporations from entering small firm industries by the merger route, without cutting off small firm opportunity to sell out to larger corporations at the same time.

(ii) A small industry is, virtually by definition, one that is easy to enter de novo; and giving small firms protection against large firm entry by merger would be to give them but a paper shield.

(3) A third possibility of small business aid from size-based legislation may be to protect wholesalers and retailers against the inconveniences associated with changes in the corporate affiliation of suppliers, including the possibility that the acquiring company may franchise additional dealers or wholesalers, try to push additional lines,

increase pressure to maintain inventories, or otherwise change old ways of doing business. It seems unlikely that support for this purpose could survive its explicit statement; we may not all like it, but a competitive system is a pressure system, and if mergers increase pressure on intermediate distribution, they are to that degree at least procompetitive.

(4) A fourth possible theory is that size-based legislation might protect small business by limiting the growth of larger corporations, thus opening increased opportunities for smaller firms. But this theory runs up against the point made under (2) above. The fact that an industry includes a number of small firms is prima facie proof that it can be entered de novo without any great expenditure of resources; and if for some reason a large diversifying corporation sees a business opportunity in such an industry, a law against entering by merger would not prevent it from entering.

On the other hand, if the acquired company's industry is one in which small firms have not been able to compete successfully, it may well be somewhat more difficult for a large diversifying company to enter de novo, for much the same reasons that small firms have difficulty entering de novo and competing profitably. But keeping large firms out of industries where small firms do not compete successfully will not add appreciably to the opportunities open to small firms.

(5) Another possibility -- or at least an expression of concern -- is that large firms entering a market by merger can then drive smaller competitors out by predatory pricing.[a] While this relationship of predatory pricing to large firm acquisitions is obscure at best, we do think it appropriate to comment, while first reminding that predatory pricing is already a violation of Section 2 of the Sherman Act.

(a) There is an extensive antitrust and economic literature regarding predatory practices of all kinds. The arguments are considered in R.H. Bork, The Antitrust Paradox (New York: Basic Books, 1978), pp. 144-160, with references to the literature at 445. A conclusion shared with Professor Bork by Professors Areeda and Turner is that predatory pricing is extremely rare.

Predatory pricing involves two elements: (1) Selling at prices low enough to drive competitors out of business. (2) An intention to recoup losses resulting from (1) by raising prices after competitors are eliminated from the market.

The first element -- selling at low prices -- is procompetitive and not contrary to public policy. In order not to suppress bona fide price competition, the courts have been, in most cases, careful to insist on persuasive evidence of the second element.

Often the second element is difficult to prove, not because it involves a matter of intent, but primarily because it is hard to believe that any wouldbe monopolist could have expected to be left alone long enough to recoup its losses. If it is easy to enter a market -- and almost any time one is dealing with predatory pricing charges originating with small businessmen, one is dealing with an industry that is easy to enter -- then almost as soon as the putative monopolist starts to cash in on the elimination of competitors, others will come back into the market and the same game will start all over again, long before the losses from the last round of price cutting have been recovered.

Another credibility-complicating factor is that in many small-firm industries, there are large wholesale and retail chains on the edge of the market entirely capable of protecting themselves and their customers from monopoly pricing. Someone once remarked that an industry with ten manufacturers making a product not sold by Sears was likely to be less competitive than an industry with one manufacturer making a product that was sold by Sears. There are similar large scale merchandisers in most consumer goods markets.

A third factor is the presence of foreign competitors. Among the manufacturing counterparts of the modern supermarket, one of the largest is the Swiss firm Nestle, and somehow it is hard to visualize anyone expecting to drive them out of the market for long.

Often it is argued that a firm which is making profits in one product line can use those profits to drive competitors out of some other product line. No doubt it can; it can also stack them in the factory parking lot and use them to start a bonfire. The question, obviously, is not what it can do with them, but what it has a profit incentive for doing with them. For the reasons indicated above, the multiline company is unlikely to see a profit incentive for selling at a loss on the speculation that large and small foreign and domestic competitors will later allow it peacefully to recoup its losses by charging high prices.

For these reasons, it is not always a kindness to small businessmen to go along with the idea that their troubles are due to predatory pricing, even though they themselves may sometimes advance it. What could be more helpful to small businessmen is a correct diagnosis of why they may be having trouble competing with a larger firm, multiline or otherwise, followed by exploration of the possibilities of giving assistance, either in remedying the disadvantage or, if the disadvantage is inherent, in shifting to a more promising business.

Thus, the notion that the brewing industry is being destroyed by predation is hard to reconcile with the performance of the G. Heileman Brewing Company, which, with 1977 sales of $265 million, or about a seventh of the sales of Anheuser-Busch, had a 10-year (1967-77) average return to investors of 17.09%, as compared to 1.27% for Anheuser-Busch. See 1978 Fortune Double 500 Directory. It seems much more likely that Heileman has grasped some aspect of the business that has escaped less successful firms than that the industry was been visited by predation.

Similar, the McKinsey & Co. finding that the largest 200 account for 75% of manufacturing exports suggests a need for a careful inquiry to ascertain what can be done to increase the role of small business industries in export markets. Conceivably, increasing exports by smaller firms may require cooperative marketing arrangements of a character that would raise issues of antitrust policy.

Again, it may sometimes happen that single-line or non-integrated producers are at an inherent disadvantage and ought to face the question of whether they are in the right business. Thus, when supplies are abundant and cheap, it is more profitable not to be saddled with investment in things like oil reserves and paper mills. The non-integrated refiners gained market share on the integrated refiners for some years before the Arab embargo. But when supplies get tight, the advantage shifts toward the integrated company. Perhaps the risk is not always as clear in advance as in retrospect, and it may be partly a problem of buying producer goods in a world economy overheated by inflation and running out of plant capacity. Such problems need to be addressed and they need to be solved, but mergers are more likely to be part of the solution than part of the problem.

CONCLUSION

Acquisitions and mergers are a normal economic tool for dealing with certain specific business problems, involving diversification from mature industries into newer and more promising fields, withdrawal from industries which have been found to pose environmental or health problems, and the maintenance of balanced cash flow in the businesses composing the diversified enterprise. The view that most mergers and acquisitions today are "empire building" does not rest on an informed examination of the business basis for merger activity nor on a knowledgeable understanding of the efficiencies sought by mergers.

Simply put, acquisitions and mergers have been of substantial benefit to a class which has, in the American economy of the post-1965 period, ranked as a disadvantaged group -- the American investor. It would take something far more than the "aggregate concentration" concept to justify overriding investor interests to the point of severely restricting mergers and acquisitions.

We believe that the membership of the National Chamber is virtually unanimous in wishing to encourage the continued successful growth of business enterprise of all sizes, including firms which are not numbered among the largest 200, 100, 50, 1000 or any other special class, and further including not only those with fewer than 100 employees, but the many enterprises in the size between "small" and "the largest so-and-so." We would be concerned if firms with fewer than 100 employees were disappearing from the economy; we would be concerned if firms with assets in the under-$1 million size class, or in the $1-$10 million size class, or in the $10-$100 million size class, or in the $100-$1000 million size class, or in the

$1-$10 billion size class, or in the $10-$100 billion size class, were disappearing from the economy. Any of these events would indicate the existence of serious economic problems.

The idea of trying to restrict the growth of the largest 200 (or any other number) firms in some class or other, however measured, seems to us to have an embarrassing kinship to the old idea of prohibiting freight trains from carrying a last car. We favor growth by the largest 200, especially in the export markets where they have been carrying 75% of the load, but also wherever else they can contribute to breaking out of our present pattern of stagflation into a new period of rising real incomes for all groups in American society.

We favor growth by the smallest 200 and the business firms in between, for exactly the same reasons we favor growth by the largest 200.

We know of no evidence that growth in any business size class implies or causes a decline in growth in other size classes; on the contrary, historically all size classes have grown together and stagnated together. We do not expect to reach a point where we will be concerned about the aggregate concentration ratio. At its right level it will allow room for all size classes to grow within the limits of their economic potential to serve the American consumer.

As we see obstacles arise to business firms' making the best use of their resources and potential, we will continue to express our concern on Capitol Hill long before the results show up in aggregate concentration figures. In fact, the efforts of the National Chamber in such fields as taxation, economy in Government, deregulation, labor reform, and opposition to excessive Government-imposed paperwork all reflect efforts to achieve the

best copy available

removal of obstacles to business growth which handicap small firms even more seriously than they handicap large firms. The simple truth is that the National Chamber is not in favor of handicapping any kind of legitimate business, large or small, in its job of contributing to the American economy.

Table 5. Text Reference: Page 23

Fortune 50 Largest Industrials, by Assets: 1977

Rank	Firm	Assets	Code
1	Exxon	38453	P
2	General Motors	26658	A
3	Mobil	20576	P
4	Ford Motor	19241	A
5	IBM	18978	AO
6	Texaco	18926	P
7	Standard Oil (Calif.)	14822	P
8	Gulf Oil	14225	P
9	General Electric	13697	E
10	Standard Oil (Indiana)	12884	P
11	IT&T	12286	M
12	Atlantic Richfield	11119	P
13	U. S. Steel	9914	S
14	Shell Oil	8877	P
15	Tenneco	8278	M
16	Standard Oil (Ohio)	7778	P
17	Dow Chemical	7675	C
18	Chrysler	7668	A
19	E.I.du Pont de Nemours	7430	C
20	Union Carbide	7423	C
21	Continental Oil	6625	P
22	Eastman Kodak	5904	C
23	Western Electric	5876	E
24	Phillips Petroleum	5837	P
25	Westinghouse Electric	5528	E
26	Sun	5181	P
27	Xerox	4906	AO
28	Bethlehem Steel	4899	S
29	Union Oil	4725	P
30	Goodyear Tire & Rubber	4678	AO
31	Procter & Gamble	4487	C
32	RCA	4352	E
33	Monsanto	4350	C
34	Caterpillar Tractor	4346	AO
35	R.J.Reynolds Industries	4334	AO
36	Getty Oil	4173	P
37	Gulf & Western	4159	M
38	Occidental Petroleum	4134	P
39	Philip Morris	4048	M
40	Weyerhauser	4038	AO
41	International Paper	3840	AO
42	Aluminum Co. of America	3802	AO
43	International Harvester	3788	AO
44	Cities Service	3740	P
45	Minnesota Mining & Mfg.	3530	C
46	Marathon Oil	3446	P
47	Firestone Tire & Rubber	3396	AO
48	Rockwell International	3392	M
49	Deere	3366	AO
50	Amerada Hess	2998	P
	Total . .	$418786	

Notes

Assets in $000,000's.

Industry codes:

P = Petroleum
A = Automobiles
AO = All other
E = Electricals
C = Chemicals
M = Multicompanies
S = Steel

Note that these are not the 50 largest corporations by sales. They are also not the 50 largest corporations by assets: the following are larger:

	Assets
AT&T	93972
Prudential	46424
Metropolitan	39576
BankAmerica	81989
Citicorp	77112
Chase Manhattan	53180

38 banks, 18 life insurance companies, 19 "diversified financial" companies, 3 retailing companies, 1 airline, 22 utilities, and 5 railroads have $3 billion or more in assets. That is, 106 "non-industrials" are larger than the 50th industrial.

Table 1.
Multicompanies

THE CONGLOMERATES

FORBES, January 8, 1979, p. 239, lists 44 "multicompanies." 35 of these match FORTUNE 500 lists. 2 are listed as non-manufacturing companies by FORTUNE, and 7 are not on the FORTUNE lists, whether because of name mismatches or classification outside manufacturing. FORBES does not list sales or assets. So the 35 manufacturing companies are listed as follows from FORTUNE, in order of sales rank, and with assets given.

Sales Rank	Company	Assets $000,000's	Headquarters Location
11	ITT	12,285 (1)	New York
19	Tenneco	8,278 (2)	Houston
31	Rockwell International	3,392 (4)	Pittsburgh
34	United Technologies	2,979 (5)	Hartford
43	LTV	2,066 (9)	Dallas
51	W. R. Grace	2,941 (6)	New York
59	Gulf & Western	4,159 (3)	New York
69	Litton	2,064 (10)	Beverly Hills
76	TRW	2,057 (11)	Cleveland
79	Signal Companies	2,153 (8)	Beverly Hills
89	Raytheon	1,813 (12)	Lexington, Mass.
[illegible]	Textron	1,738 (14)	Providence
99	Singer	1,462 (15)	New York
112	Teledyne	1,420 (17)	Los Angeles
133	Northwest Industries	1,765 (13)	Chicago
134	IC Industries	2,613 (7)	Chicago
142	American Standard	1,127 (18)	New York
154	Dart Industries	1,440 (16)	Los Angeles
156	Ogden	1,022 (20)	New York
173	Walter Kidde	1,107 (19)	Clifton, N. J.
182	White Consolidated	934 (21)	Cleveland
183	SCM	768 (24)	New York
190	U. S. Industries	837 (22)	New York
204	AMF	827 (23)	White Plains, N. Y.
216	Chromalloy American	752 (25)	St. Louis
242	Brunswick	732 (26)	Skokie, Ill.
262	Lear Siegler	584 (27)	Santa Monica, Calif.
298	Whittaker	481 (28)	Los Angeles
352	Sybron	439 (29)	Rochester, N. Y.
360	Dayco	325 (32)	Dayton
363	A-T-O	377 (31)	Willoughby, Ohio
365	Bangor Punta	395 (30)	Greenwich, Conn.
379	National Service Industries	271 (33)	Atlanta
460	Scott & Fetzer	225 (34)	Lakewood, Ohio
568	Allied Products	171 (35)	Chicago

TOTAL ASSETS (35 Companies) 65,999.

(Figures in parentheses are asset rank among 35 multicompanies.)

Notes: (1) The top six conglomerates have just over 50% of the assets of the 35 companies.

(2) The top industrial company (Exxon) has more assets than the 6 top multicompanies the top two industrials have 98.66% as much in assets as all 35 multicompanies.

(3) Companies larger than the largest multicompany (i.e., the 10 companies larger than ITT) have just over 3 times the assets of the [illegible] multicompanies.

(4) Five multicompanies are among the top 50 manufacturing companies in asset size; [illegible] make the top 100, 20 make the top 200, and 34 make the top 500.

Appendix A

Text Reference: Page 20

Statement Regarding Enclosed Tables Showing Manufacturing Establishments That Went Out of Business in 1975

Enclosed is a special tabulation of plants in the annual survey of manufactures sample that had indicated they had gone out of business in 1975.

The enclosed Table 1 provides information on the total number of establishments that ceased operation in 1975. The figures are further subdivided by the average employment size of the establishment during 1974.

In the regular processing of the ASM, establishments are deleted and assigned out-of-business status codes for a number of reasons. These include the following:

a. Company has gone out of business and operations of that plant have ceased.

b. Company continues operations but the specific plant has ceased operating. Activities of the plant may have been transferred to a plant that was previously operating at another location, to a new plant, or may have been discontinued.

c. The specific plant became inactive in 1975 and has remained inactive in 1976.

An establishment is not considered to be out of business when it continues to operate even though there is a change in ownership.

We have also compiled some related information that may be helpful in your analysis of the plant closing data. Table 2 contains 1975 and 1974 manufacturing employment data by major industry group as published in the annual survey of manufactures for the respective years. The net change in employment is accounted for by such diverse factors as expansions or declines in plant operations, new plants coming into production, plant closings, etc. In addition, it was possible to develop estimates of the amount of the change in manufacturing employment that resulted from plant closings.

We do not plan to publish these statistics. If you release them, it would be appreciated if the Bureau of the Census is cited as the source. We suggest including the note regarding the limitations of the data in any publication of this information.

1974-1975 Annual Survey of Manufactures

Table 1. Establishments That Have Gone Out of Business During 1975 By 1974 Size Class

Employment Size of the Establishment in 1974	Establishments (Number)	1974 Employment (000)	Standard Error of Estimate (Percent) For--	
			Estab.	Employ.
1-19	22,925 .82	108.7 .23	6	6
20-49	3,127 .93	97.7 .43	7	8
50-99	1,050 .97	71.8 .58	8	7
100-249	630 .99	93.2 .78	5	4
250-over	225 1.00	107.8 1.00	1	1
Total	27,957	479.2	5	3

NOTE: The statistics presented in this tabulation are estimates compiled from a probability sample of about 70,000 manufacturing establishments selected from a universe of about 312,000 establishments. The sample was selected from the 1972 Census of Manufactures list supplemented by a sample of manufacturers that started operation after 1972.

All establishments of companies that had one or more manufacturing establishments with 250 employees or more in the 1972 Census were included in the survey panel. Smaller companies were sampled with probabilities of selection based on a measure of size determined for each company.

The estimates developed from this sample are apt to differ somewhat from the results of a comparable complete coverage survey. These differences are known as sampling errors. Estimates of these sampling errors are identified in the table as the "Standard Error of Estimate." In addition to sampling errors, the estimates are subject to various response and operational errors such as: errors of collection, reporting, coding, transcription, imputation for non-response, etc. These operational errors would also occur if a complete canvass were to be conducted under the same conditions as the survey.

The tabulation of the establishments that went out of business was based primarily on the information supplied by the respondent regarding the status of the establishment in 1975 and 1974. This information is used mainly for internal controls and, consequently, is not edited as intensively as other data items on the report forms. While no known systematic errors exist in the assignment of the status codes, individual errors do occur in the assigning of codes.

The standard error of estimate partially measures the effect of operational errors but does not measure any systematic biases in the data. Bias is the difference, averaged over all possible samples, between the estimate and the desired value. Obviously, the accuracy of a survey result depends upon both the sampling and nonsampling errors, measured by the standard error, and the bias and other types of nonsampling error, not measured by the standard error.

Due to difficulties in sample maintenance for the very small manufacturing companies, there has been a coverage loss in the annual survey of manufactures of about 2-3 percent a year, following the census of manufactures, in terms of the inflated establishment count. While this loss has virtually no effect on estimates of total manufacturing activity, it does result in underestimates for the number of establishments and for other statistics for the smaller size classes. This downward bias, which is likely to be on the order of 6-8 percent for the number of establishments and for employment for the 1-19 employment size class, is not reflected in the standard errors, which are similarly underestimated.

Enclosure
Page 3

Table 2. Total Manufacturing Employment By Industry Group 1976 and 1975 Compared With Employment of Establishments That Went Out of Business in 1975

* Code	Industry Group	Total Employees (000)			1976 Employment of Establishments That Went Out of Business in 1975		
		1975	1976	1975 - 1976	Total Employees (000)	Percent of 1976 Employment	Standard Error of Estimate (Percent)
20	Food and Kindred Products	1,327.3	1,351.7	- 24.4	37.4	2.8	5
21	Tobacco Products	66.2	67.6	- 1.4	2.1	3.1	2
22	Textile Mill Products	838.4	931.5	- 93.1	30.7	3.3	7
23	Apparel, Other Textile Products	1,212.5	1,316.7	-104.2	84.8	6.4	10
24	Lumber and Wood Products	591.7	674.2	- 82.5	41.0	6.1	6
25	Furniture and Fixtures	397.8	459.3	- 61.5	18.6	4.0	9
26	Paper and Allied Products	589.5	648.2	- 58.7	8.2	1.3	8
27	Printing and Publishing	1,072.8	1,075.7	- 2.9	32.5	3.0	12
28	Chemicals, Allied Products	848.1	865.3	- 17.2	10.0	1.1	8
29	Petroleum and Coal Products	141.1	145.6	- 5.6	1.0	0.7	4
30	Rubber, Miscellaneous Plastic Products	587.4	661.3	- 73.9	14.8	2.2	11
31	Leather, Leather Products	240.0	255.8	- 15.8	10.7	4.2	17
32	Stone, Clay, Glass Products	591.6	638.7	- 47.1	17.8	2.8	9
33	Primary Metal Industries	1,090.6	1,247.8	-157.2	14.2	1.1	7
34	Fabricated Metal Products	1,419.9	1,576.7	-156.8	36.9	2.3	7
35	Machinery, Except Electric	1,979.2	2,126.1	-146.9	42.8	2.0	8
36	Electric, Electronic Equipment	1,520.9	1,775.5	-254.6	28.5	1.6	8
37	Transportation Equipment	1,604.4	1,738.0	-133.6	22.0	1.3	6
38	Instruments, Related Products	502.0	524.1	- 22.1	6.3	1.2	14
39	Miscellaneous Manufacturing Products	394.9	435.0	- 40.1	18.7	4.3	9
	Total	17,216.3	18,712.6	-1,496.3	479.2	2.6	2

Source: Annual Survey of Manufactures, General Statistics for Industry Groups and Industry M75(AS)-1.
See Note on Table 1.

(59)

Text Reference: Page 36

APPENDIX B

[illegible]

[illegible]

Year	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	(1)	(2)	(3)	(4)	(5)
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]					[illegible]
[illegible]					[illegible]
[illegible]					[illegible]

[illegible]

[illegible]

	[illegible]	[illegible]	[illegible]
[illegible]			
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]

[illegible]

APPENDIX QQ.—BIBLIOGRAPHY ON EFFECTS OF MERGERS ON LOCAL COMMUNITIES, COMPILED BY GWENELL BASS, CONGRESSIONAL RESEARCH SERVICE

THE LIBRARY OF CONGRESS
Congressional Research Service

WASHINGTON, D.C. 20540

December 18, 1979

TO : House Small Business Committee
Attention: Mark Levine

FROM : Gwenell Bass
Analyst in Industrial Organization and Corporate Finance
Economics Division

SUBJECT : Effects of mergers on the local community

This memorandum is in response to your request for studies which measure the effects of a merger on a local community. You also indicated that you were interested in studies on conglomerate mergers. We extensively searched several indexes to obtain listings of research studies in these areas.

The Business Periodical Index provides the most comprehensive listing of corporate mergers. This index identifies specific cases. The only problem is that it indexes business magazines and newspapers which in many instances, do not publish theoretical studies. However, for your purposes, this index was the best source that we could locate that would identify cases located throughout the nation.

We also searched the Index to Legal Periodicals from September 1957 through July 1979. This periodical proved to be a great reference source for theoretical studies on mergers and acquisitions. However, the legal studies indexed in this periodical all address conglomerate mergers from a macroeconomic perspective as opposed to a microeconomic approach.

Another periodical which we searched was the American Economic Association's Index of Economic Articles from 1969-1975. For later years 1976-1979, we searched the Journal of Economic Literature. As the titles of these periodicals suggest, they are indexes of economic articles. Like the legal articles on conglomerate mergers, the major focus of the economic articles was the aggregate aspects of mergers.

We also performed a computer search of three private bibliographic files. The files which we searched are ABI/Inform from 1971-1979, Comprehensive Dissertation Abstracts from 1961-1979, and Economic Abstracts International from 1973-1979.

Based on this research, we have found that most technical and theoretical studies do not examine the local effects of conglomerate mergers. Even the studies which look at the microeconomic effects of mergers address this aspect from a simulated point of view. However, the more journalistic pieces do look at this aspect of conglomerate mergers.

We are sending you two books on mergers. They are entitled Steiner, Mergers, and Stacey, Mergers in Modern Business. If we can be of further assistance, please call 287-5755.

sep

CRS-3

BIBLIOGRAPHY ON BUSINESS CONGLOMERATES

Index to Legal Periodicals

(Searched from September 1967 to July 1979)

Acquisitions under antitrust attack: shaping the merger transaction: a panel. (Sterling, Reycraft, Archer, Dam). Business law v. 25, Jan. 1970: 787.

Analysis of the merger movement — antitrust aspects: a panel. (Decker, Hampton, Adler, Elman, McGovern). Business law, v. 25, Jan. 1970: 652.

Antitrust aspects of takeovers and mergers: the Hart-Scott-Rodino Antitrust Improvement Act of 1976 — a panel, an overview. I.M. Millstein, Substantive Requirements, B. Riche, Procedural Requirements, E. Fox, Tactics and Strategy, S.M. Axinn. Business law, v. 32, May 1977: 1517-1532.

Antitrust: conglomerate mergers and Section 7 of the Clayton Act. Maryland law review, v. 33, 1973: 96-116.

Antitrust law — conglomerate mergers — a company in a concentrated industry with a less than 10 percent share of relevant market will be presumed a "toehold" firm, acquisition of which by a potential competition does not violate Section 7 of the Clayton Act. Harvard law review, v. 89, Feb. 1976: 800-812.

Antitrust law — conglomerate mergers — merger followed by overt attempt to secure sales through reciprocity held violative of both Clayton and Sherman Acts. New York University law review, v. 42, Oct. 1967: 733.

Antitrust policy and the conglomerates. I.M. Stelzer. St. John's law review, v. 44, Oct. 1969: 196.

Antitrust — past — acquisition evidence and conglomerate mergers. North Carolina law review, v. 46, Feb. 1968: 366.

Antitrust symposium — conglomerates and concentrations, G. Means; the political ramifications of antitrust and conglomerate mergers, E. Lofen; mergers and the antitrust laws; Univ. of Miami law review, v. 25, fall 1970: 1.

Arguing the guidelines for conglomerate mergers. California Western review, v. 5, fall, 1968: 101.

Bigness and diversification: the conglomerate, R.L. Hruska, American Bar Association antitrust law journal, v. 38, 1968-1969: 192.

Challenging conglomerate mergers under Section 7 of the Clayton Act: Today's law and tomorrow's legislation. L.P. Bauer, Boston University law review, v. 58, May 1978: 199-243.

Clayton 7 and the pure conglomerate: the business of buying business. Univ. of Pittsburgh law review, v. 35, fall 1973: 115-139.

Clients and conglomerates: how to hook the conglomerate, D.I. Baker. Trial V. 5, Apr.-May 1969: 9.

Concepts of a conglomerate on a multi-market company: a businessman's view, H.S. Geneen; the conglomerate and antiturst: a businessman's view, J. J. Ling; an economist's view, I.M. Stelzer. American Bar Association antitrust law journal, v.39, 1969-1970: 6.

Conglomerate m.. tax reform: a brief review, P.J. Gee. Tax law review, v. 25, Jan. 1970: 235.

Conglomerate bank mergers and Clayton 7: is potential competition the answer?, A.B. Willoxy, H.M. Willoxy. Banking law journal, v. 93, Feb. 1976: 148-195.

Conglomerate corporation and Section 7: the limitations of the Anti-Merger Act, J. Davidow. Columbia law review, v. 68, Nov. 1968: 1231.

Conglomerate mergers: a neglected aspect, T.P. Sharp, D. Statman. Mississippi law journal, v. 43, Nov. 1972: 630.

Conglomerate merger: a new source of antitrust crisis, A.D. Austin. Case west reserve law review, v. 21, Feb. 1970: 181.

Conglomerate mergers and acquisitions: opinions and analysis: a symposium. St. John's law review, v. 44, spring 1970: 329. (special edition)

Conglomerate mergers and criteria for defining potential entrants, D. Berger, W. Peterson. Antitrust bulletin, v. 15, fall 1970: 489.

Conglomerate mergers and the antitrust laws, H.M. Blake. Columbia law review, v. 73, Mar. 1973: 555.

Conglomerate mergers: proposed guidelines, S. Bryan. Harvard journal legislation, v. 11, Dec. 1973: 31-62.

Conglomerate merger fever: the 1967 virus, F.R. Dixon, American Bar Association antitrust law journal, v. 34, 1967: 103.

Conglomerate merger investigation, E. Celler. American Bar Association antitrust law journal, v. 38, 1968-1969: 186.

Conglomerate merger: a special case, S.R. Reid. Antitrust law and economics review, v. 2, fall 1968: 141.

Conglomerate mergers, W. Kay. Journal of business law, v. 1969, Oct. 1969: 283.

Conglomerate mergers, A.J. Marinelli. American business law journal, v. 11, spring 1973: 1.

Conglomerate mergers. Notre Dame law, v. 45, summer 1970: 698.

Conglomerate mergers, allocative efficiency and Section 7 of the Clayton Act, E.H. Mantell. Texas law review, v. 56, Jan. 1978: 207-241.

Conglomerate mergers and the antitrust laws, R.A. Hammond, III. Utah law review, v. 1969, Sept. 1969: 646.

Conglomerate mergers and taxation, S.S. Cohen. American Bar Association antitrust law journal, v. 55, Jan. 1969: 40.

Conglomerate mergers: extended interdependence and effects on interindustry competition as grounds for condemnation, P. Areeda and D. Turner. Univ. of Pennsylvania law review, v. 127, April 1979: 1082-1103.

Conglomerate merger syndrome — a comparison: congressional policy with enforcement policy, J.C. Thomas. Fordham law review, v. 36, Mar. 1968: 461.

Conglomerate mergers under Section 7 of the Clayton Act. R.A. Hicks, W.B. Comegys, Jr., S. Lewis. Business law, v. 28, Mar. 1973: 83.

Conglomerate mergers and the future: a panel (Bodnero, Jr., Adler, Jr., Hammond, III, Mueller, Schwartz). American Bar Association antitrust law journal, v.37, 1968: 318.

Conglomerate mergers and the theory of reciprocity. Stanford law review, v. 22, April 1970: 812.

Conglomerate mergers in perspective. W.G. Shepherd, comment on Professor Shepherd's conglomerate mergers in perspective. J.F. Weston; comment D.D. Martin. Antitrust law and economics review, v. 2, fall 1968: 15.

Conglomerates and other modern merger movements: a symposium. Business law, v. 25, Jan. 1970: 555.

Conglomerates and Section 7: is size enough? Columbia law review, Feb. 1970: 337.

Conglomerate phenomenon, H.S. Ackerman. South Dakota law review, v. 16, winter 1971: 90.

Conglomerates: the rhetoric and the evidence, J.H. Lorie, P. Halpern. Journal of law and economics, v. 13, April 1970: 169.

Leading firm conglomerate mergers, J.S. Campbell, W.G. Shepherd. Antitrust bulletin, v. 13, winter 1968: 1361.

Legal semantics of conglomerate diversification, J.M. Patterson, D.J. Patterson. American business law journal, v. 5, winter 1967: 273.

Measuring conglomerate concentration: a proposal, J. Horvath. Antitrust bulletin, v. 17, fall 1972: 885.

Media conglomerates, antitrust law, and the marketplace of ideas. Memphis St. Univ. law review, v. 9, winter 1979: 257-280.

National institute on conglomerates and other modern merger movements, American Bar Association antitrust law journal, v. 39, 1969-1970: 1.

Noncase guidelines for conglomerate mergers under Section 7 of the Clayton Act. New York University law review, v. 45, Mar. 1970: 90.

Potential reciprocity and conglomerate mergers: Consolidated Foods revisited, E.A. Hinnegan. Buffalo law review, v. 17, spring 1968: 631.

Panel discussion: pros and cons of conglomerates as they affect transportation (Waters, Hershey, Donnen, Bernard, Hamilton), ICC practice journal, v. 37, Sept.-Oct. 1970: 37.

Potential reciprocity and Section 7 of the Clayton Act; conglomerate mergers under antitrust attack. Texas law review, v. 48, Mar. 1970: 810.

Present guidelines for conglomerates. North Dakota law review, v. 44, winter 1968: 226.

Private enforcement of the antimerger laws: a symposium (Turner, Halverson, Berger, Fox). Record, v. 31, April 1973: 239-263.

Proctor and Gamble - Clorox (FTC vs. Proctor and Gamble and 87 Sup. Ct. 1224) and the economics of conglomerate mergers, W. Sichel. Antitrust bulletin, v. 14: 10.

Pure conglomerate mergers and Section 7 of the Clayton Act. Georgia law review, v. 3, spring 1969: 579.

Reciprocity and conglomerate mergers under Section 1 of the Sherman Act and Section 7 of the Clayton Act, R.C. Jewell. Albany law review, v. 33, spring 1969: 459.

Rising economic concentrations in America: reciprocity, conglomeration and the New American "Zaibatsu" system, W.F. Mueller. Antitrust law and economics review, v. 4, spring-summer 1971: 15, 91.

Role of the conglomerates in the American entertainment industry, J. Tamberman. Univ. of Toronto.

Symposium: the conglomerate corporation. Loyola Univ. law review (LA) v. 3, April 1970: 207.

Use of Section 5 of the Federal Trade Commission Act to attack large conglomerate mergers, P.C. Carstenson, N.H. Questal. Cornell law review, v. 63, June 1978: 841-878.

Index of Economic Articles 1969-1979
American Economic Association

Alberts, William. The profitability of conglomerate investment mergers: sources and prospects. Univ. of Washington business review, v. 29, no. 2, winter 1970: 13-27.

-----. The proper role of mergers in conglomerate growth. Univ. of Washington business review, v. 31, no. 1, autumn 1971: 5-21.

Arnould, Richard. Conglomerate growth and profitability. Garoian, v. 1969: 72-80.

Attiyeh, Robert S. The bashful conglomerates. Univ. of Washington business review, v. 28, no. 4, summer 1969: 5-11.

Bachman, Julius. Conglomerate mergers and competition. Economic concentration, Pt. 8. Senate Committee Hearings, 1970: 5269-5297.

-----. Conglomerates: economic arguments pro and con. Economic concentration, Pt. 8. Senate Committee Hearings, 1970: 5299-5383.

Berger, Daniel and Mark Peterson. Conglomerate mergers and criteria for defining potential entrants. Antitrust bulletin, v. 15, fall 1970: 489-503.

Bernstein, Peter L. The evil conglomerate: myth or reality. 1970: 218-223.

Bicksler, James L. The effects of conglomerate merger activity on systematic rich: comment. Journal of financial quantitative analysis, v. 9, no. 2, Mar. 1974: 227-230.

Blair, John M. An overview of conglomerate concentration. Garoian, v. 1969: 1-20.

Briloff, Abraham. Financial motions for conglomerate growth. Garoian 1969: 81-87.

Burnstein, M.L. Conglomerate merger: an economic primer. Intermountain economic review, v. 2, no. 1, spring 1971: 1-14.

Carroll, Daniel. What future for the conglomerate. Harvard business review, v. 47, no. 3, May-June 1969: 255-298.

Colis, David. Erratic results from the merger ratio. American journal of agricultural economics, v. 52, no. 3, Aug. 1970: 452-453.

Conn, Robert L. Acquired firm performance after conglomerate merger. Southern economic journal, v. 43, no. 171, Oct. 1976: 1170-1174.

-----. Performance of conglomerate firms: comment. Journal of finance, v. 28, no. 3, June 1973: 754-758.

-----. Some evidence on failing firm/industry motives in conglomerate mergers. Mississippi Valley journal of business economics, v. 10, no. 2, winter 1974-1975: 84-88.

-----. The failing firm/industry doctrines in conglomerate mergers. Journal of industrial economics, v. 24, no. 3, Mar. 1976: 181-187.

Dean, Joel. Growth by conglomerate merger in U.S.A. Some economic cases and consequences. L'Imprisa, v. 12, no. 4, July-Aug. 1970: 343-357.

-----. Some causes and consequences of conglomerate mergers. Economic contentration, Pt. 8. Senate Committee Hearings, 1970: 5253-5267.

-----. Some causes and consequences of conglomerate mergers. Investigation of conglomerates. House Committee Hearings, 1970: 310-324.

Edwards, Corrin D. The large conglomerate firm: a critical appraisal. Mansfield E., ed., 1974: 110-114.

Felton, John Richard. Conglomerate mergers, concentration and competition. American journal of economics and sociology, v. 30, no. 3, July 1971: 225-242.

Goldberg, Lawrence G. Conglomerate mergers and concentration ratios. Review of economic statistics, v. 56, no. 3, Aug. 1974: 303-309.

-----. The effect of conglomerate mergers on competition. Journal of law and economics, v. 16, no. 1, April 1973: 137-158.

Goudzawend, Marci B. Conglomerate mergers, convertibles and cash dividends. Quarterly review of economics and business, v. 9, no. 1, spring 1969: 53-62.

Hassid, J. Recent evidence on conglomerates in U.K. manufacturing industry. Manchester scholastic economic society study, v. 43, no. 4, Dec. 1975: 372-395.

Heflilaner, Richard. The conglomerate in American industry: a special antitrust wrinkle. Sichel W., ed., 1970: 81-101.

Hempel, George H and Ronald W. Melicher. Financial characteristics of merging companies: differences between conglomerates and traditional mergers. Journal of economics and business, v. 27, no. 1, fall 1974: 17-24.

Higgins, Robert C. and Lawrence D. Schall. Corporate bankruptcy and conglomerate merger. Journal of Finance, v. 30, no. 1, Mar. 1975: 93-113.

Holzmann, Oscar J., Ronald M. Copeland and Jack Hayya. Income measures of conglomerate performance. Quarterly review of economics and business, v. 15, no. 3, autumn 1975: 67-78.

Honeycutt, T. Crawford. The microeconomic consequences of corporate mergers: a comment. Journal of business, v. 4, no. 2, Apr. 1975: 267-274.

Horvath, James. Measuring conglomerates concentration: a proposal. Antitrust bulletin, v. 17 no. 3, fall 1972: 885-909.

Ijiri, Yuji and Herbert A. Simon. Effects of mergers and acquisitions on business firm concentration. Journal of political economy, v. 79, no. 2, Mar.-Apr. 1971: 314-322.

Jacoby, Neil H. The conglomerate — corporation of the future? Investigation of conglomerate corporations. House Committee Hearings, 1970: 324-329.

Kamerschen, David. A theory of conglomerate mergers: comment. Quarterly journal of economics, v. 84, no. 4, Nov. 1970: 668-673.

Logue, Dennis E. and Philipp Naert. A theory of conglomerate mergers: comment and extension. Quarterly journal of economics, v. 84, no. 4, Nov. 1970: 663-667.

Lorie, James. Conglomerate mergers: some evidence and comments on the soundness of complicated securities ("Funny Money") and on reciprocal dealings. Economic concentration, Pt. 8. Senate Committee Hearings, 1970: 4745-4751.

Lorie, James H. and Paul Halperin. Conglomerates: the rhetoric and the evidence. Journal of law economics, v. 13, no. 1, April 1970: 149-166.

Madsen, Albert G. and Richard Walsh. Conglomerates: economic conduct and performance. American journal of agricultural economics, v. 51, no. 5, Dec. 1969: 1495-1505.

Markham, Jesse W. The conglomerate firm; a factual analysis. In Weston, J.F. and Ornstein, S.I., eds. 1973: 185-201.

Melicher, Ronald W. and David F. Rush. The performance of conglomerate firms: recent risk and return experience. Journal of finance, v. 28, no. 2, May 1973: 381-388.

Melnik, A. and M.A. Pollatschek. Debt capacity, diversification and conglomerate mergers. Journal of finance, v. 28, no. 5, Dec. 1973: 1163-1173.

Mueller, Dennis C. A theory of conglomerate mergers. Quarterly journal of economics, v. 83, no. 4, Nov. 1969: 643-659.

------. A theory of conglomerate mergers: reply. Quarterly journal of economics, v. 84, no. 4, Nov. 1970: 674-679.

Mueller, Willard. Conglomerate mergers: a crisis in public policy. Nebraska journal of economic business, v. 9 no. 4, autumn 1970: 16-32.

------. Firm conglomeration as a market structure variable. American journal of agricultural economics, v. 51, no. 5, Dec. 1969: 488-494.

------. Recent changes in industrial concentration and the current merger movement. Zeitlin, ed. 1970: 19-42.

------. The threat of conglomerate power. In Crandall, R.W. and Eakans, R.S. eds. 1972: 502-566.

Narnen, John. Conglomeration in the food industry. Garoian, ed., 1969: 21-41.

Prosper, Peter A. Jr. and J. Edward Smith, Sr. Conglomerate mergers and public policy. Journal of economic issues, v. 5, no. 2, June 1971: 117-120.

Reid, Samuel R. A reply to the Weston/Mansinghka criticisms dealing with conglomerate mergers. Journal of finance, v. 26, no. 4, Sept. 1971: 937-946.

------. Conglomerate growth: consisting with economic theory of growth. Garoian, ed. 1969: 44-56.

------. Conglomerate performance measurement: reply. Journal of finance, v. 29, no. 3, June 1974: 1013-1015.

------. The microeconomic consequences of corporate mergers: comment. Journal of business, v. 48, no. 2, April 1975: 275-280.

Riesz, Peter C. Conglomerate subsidization of advertising expenditures: some empirical evidence. Antitrust bulletin, v. 19, no. 4, winter 1974: 761-782.

Samuels, John M. The successor failure of mergers and takeovers. Samuels, J.M. ed., 1972: 1-11.

Seidman, Albert G. and David Shapino. Conglomerates and the Federal Trade Commission. Manage account, v. 51, no. 10, April 1970: 21-23.

Skeffer, Jana Duncan. Some research problems concerning conglomerate firm growth. Garoian, 1969: 131-132.

Smith, Keith and John Schreiner. A portfolio analysis of conglomerate diversification. Journal of finance, v. 24, no. 3, June 1969: 413-427

Weston, J. Fred. Conglomerate and vertical responses to market imperfections: discussion. American economics review, v. 61, no. 2, May 1971: 125-27.

-----. Conglomerate firm in perspective. Intermountain economic review, v. 4, no. 1, spring 1973: 1-13.

Weston, J. Fred and Surendra K. Mansughka. Conglomerate performance measurement: comment. Journal of finance, v. 29, no. 3, June 1974: 1011-1012.

-----. Performance of conglomerate firm: reply. Journal of finance, v. 28, no. 3, June 1978: 759.

-----. Tests of the efficiency performance of conglomerate firms. Journal of finance, v. 26, no. 4, Sept. 1971, 919-936.

-----. Conglomerate performance using the capital asset pricing model. Review of economic statistics, v. 54, no. 4, Nov. 1972: 357-363.

Comprehensive Dissertation Abstracts
1961-1979

Conglomerates in the tradition of consolidation. Leidich, Paula Braga (Ph.D. University of Michigan, 1978). Dissertation abstracts international, v. 39/02-A: 1060.

Conglomerate performance in the capital market. Chapman, Margaret Lee Sullivan (Ph.D. University of Illinois at Urbana-Champaign, 1977). Dissertation abstracts international, v. 38/10-A: 6239.

Optimal pricing by a conglomerate firm under conditions of uncertainty. Bradburd, Ralph Matthew (Ph.D. Columbia University, 1976). Dissertation abstracts international, v. 38/01-A: 402.

An anlaysis of conglomerate diversification and performance. Beattie, David Leslie (Ph.D. Queen's University at Kingston [Canada], 1976). Dissertation abstracts international, v. 37/08-A: 5255.

An optimal control approach to the theory of conglomerate growth. O'Neill, Dennis Charles (Ph.D. University of Cincinnati, 1976). Dissertation abstracts international, v. 37/06-A: 3800.

Industry-specific conglomerate merger guidelines: proposals for brewing and banking. Snider, Darryl Lee (Ph.D University of Michigan, 1975). Dissertation abstracts international, v. 36/06-A: 3893.

An investigation of the use of selected financial information in determining conglomerate merger stragegy. Morgan, Robert George (Ph.D University of Georgia, 1974). Dissertation abstracts international, v. 35/10-A: 6308.

Financial characteristics of firms acquired by successful vs. unsuccessful conglomerates: a multivariate analysis. Melton, Harrold Eugene (Ph.D Louisiana State University and Agricultural and Mechanical Col., 1974). Dissertation abstracts international, v. 35/07-A: 3983.

Accounting return-risk measures of conglomerate performance. Holzmann, Oscar Jorge (Ph.D. Pennsylvania State University, 1974). Dissertation abstracts international, v. 35/03-A: 1311.

Formalized planning and its use in conglomerates. Fried, Robert Paul (Ph.D Columbia University, 1973). Dissertation abstracts international, v. 34/06-A: 2822.

Price/earnings differential as a pure conglomerate merger motive. Conn, Robert Lawrence (Ph.D. University of Houston, 1973). Dissertation abstracts international, v. 34/04-A: 1447.

Conglomerate performance as influenced by selected management practices. Ablovich, Edgar Allen (Ph.D North Texas State, 1973). Dissertation abstracts international, v. 34/04-A: 1411.

A cash flow of conglomerate mergers. Leviton, Edward Barry (Ph.D. State University of New York at Binghamton, 1973). Dissertation abstracts international, v. 34/03-A: 960.

An evaluation of regulation by the Civil Aeronautics Board of airlines operating within the conglomerate form (a case study). Larson, Dean Martin (Ph.D. American University, 1972). Dissertation abstracts international, v. 33/08-A: 3866.

Organization of conglomerates: an inquiry into the functions of their corporate offices. Nangia, Madan M. (Ph.D. New York University, 1972). Dissertation abstracts international, v. 33/07-A: 3087.

The analysis of conglomerate performance. Thomsen, David John (Ph.D. University of Oregon). Dissertation of abstracts international, v. 33/05-A: 1916.

From kiln to conglomerate: a history of the Acme Brick Company. Lehr, Edwin Ervin (Ph.D. Texas Christian University, 1972). Dissertation abstracts international, v. 33/05-A: 2291.

An explanation of the conglomerate merger movement — conglomerate as a result of forces arising in the capital markets. Treadway, Peter Theodore (Ph.D. University of North Caroline at Chapel Hill, 1971). Dissertation abstracts international, v. 32/09-A: 4816.

A study of the behavioral characteristics of conglomerates. Wood, Thomas David (Ph.D. University of Florida, 1971). Dissertation abstracts international, v. 32/09-A: 4770.

Conglomerates and insurance. Crepas, Kenneth James (Ph.D. University of Iowa, 1971). Dissertation abstracts international, v. 32/03-A: 1124.

The effects of purchase accounting and goodwill amortization on the reported profitability and acquisition programs of conglomerates. Bruns, Thomas Vincent (Ph.D. Saint Louis University, 1970). Dissertation abstracts international, v. 32/02-A: 593.

A behavioral case study of a mini-conglomerate. Brunson, Richard Wanless, Sr. (Ph.D. Michigan State University, 1970). Dissertation abstracts international, v. 31/11-A: 5587.

Conglomerate merger in United States manufacturing industries, 1958-1967. Taliaferro, Richard Taylor (Ph.D. Saint Louis University, 1970). Dissertation abstracts international, v. 31/08-A: 3752.

Security-based conglomerate acquisitions: the effect on residual ownership. Rankin, David Foster (Ph.D. University of Mississippi, 1970). Dissertation abstracts international, v.31/06-A: 2593.

Management of multi-industry (conglomerate) corporations: an investigation of decision making at the division level. Waddell, William Cooper (D.B.A. University of Southern California, 1970). Dissertation abstracts international, v. 31/04-A: 1446.

The conglomerate merger and antitrust policy. Jervey, William Haynsworth, Jr. (Ph.D. University of Arizona, 1970). Dissertation abstracts international, v. 31/03-A: 903.

A systems approach to conglomerate corporations. Smith, Joseph Edward, Jr. (Ph.D. Purdue University, 1969). Dissertation abstracts international, v. 30/11-A: 4668.

The valuation of conglomerate companies. Betty, Winfield Parker (Ph.D. North Texas State University, 1969). Dissertation abstracts international, v. 30/06-A: 2195.

Conglomerate mergers and market competition. Narver, John Colin (Ph.D. University of California, Berkeley, 1965). Dissertation abstracts international, v. 26/02: 744.

Amended Section Seven of the Clayton Act, conglomerate mergers, and preventive antitrust policy. Colwell, Billy Joe (Ph.D. Ohio State University, 1963). Dissertation abstracts international, v. 24/11: 4432.

ABI/INFORM

Politics: the new anti-merger strategy. Reilly, Ann. Dun's review, v. 11, no. 1: 32-35, 37.

The transatlantic take-over spree. Burne, Malcolm. International management, v. 34, no. 5, May 1979: 55-57.

J.B. Fuqua's grand decision. Holt, Donald D. Fortune, v. 99, no. 12, June 18, 1979: 123.

Now it's Coke the winemaker. Howard, Niles and Marjorie Siegel. Dun's review, v. 11, vo. 3, April 1979: 68-69, 73, 75.

Risk reduction and conglomerate mergers. Hexter, J.L. Review of business and economic research, v. 14, no. 1, fall 1978: 90-97.

Multicompanies. Forbes, v. 123, no. 1, Jan. 8, 1979: 238-242.

How foreign companies are buying up America. Reich, Cary. Institutional investor, v. 12, no. 12: 131-138.

Merger regulation in the United States. Stewart, I.C. Management international review, v. 18, March 1978: 43-48.

Conglomerate mergers, default risk, and homemade mutual funds. Azzi, Corr. American economic review, v. 68, no. 1, March 1978: 161-172.

Co-insurance and conglomerate merger. Lee, Li Way. Journal of finance, v. 32, no. 5, Dec. 1977: 1527-1537.

On the theory of conglomerate mergers. Scott, James H. Jr. Journal of finance, v. 32, no. 4, Sept. 1977: 1235-1250.

Merger motives - Conglomerates versus congenerics. Morgan, Robert G. Nebraska journal of economics and business, v. 16, no. 1, winter, 1977: 47-54.

Newspaper mergers - the final phase. Bagdikian, Ben H. Columbia journalism review, v. 15, vo. 6, Mar.-Apr. 1977: 17-22.

Multicompanies. Forbes, v. 119, no. 1, Jan. 1, 1977: 99-101.

The remarkable revival of RJR industries. Business week, no. 2466, Jan 17, 1977: 66-68.

Internal organizational structure and the FTC's economic report on conglomerate merger performance. Marx, Thomas G. Akron business and economic review, v. 7, no. 4, winter 1976: 12-20.

How Loews' lean management fattened profits at CNA. Business Week, no. 2636: 64-68.

Conglomerate mergers and collective-bargaining. Hendricks, Wallace. Industrial relations, v. 15, no. 1, Feb. 1976: 75-87.

The failing firm/industry doctrines in conglomerate mergers. Conn, R.L. Journal of industrial economics, v. 24, no. 3, Mar. 1976: 181-187.

Corralling the conglomerates. Berin, Barnet N. Pension world, v. 11, no. 7, July 1975: 35-36.

Conglomerate subsidization of advertising expenditures - some empirical evidence. Riess, Peter C. The antitrust bulletin, v. 19, no. 4, winter 1974: 761-782.

Corporate bankruptcy and conglomerate merger. Higgins, Robert C. and Lawrence D. Schall, Journal of finance, v. 30, no. 1, March 1975: 93-113.

Conglomerates. West, Richard R. Oregon business review, v. 34, no. 1, winter, 1975: 8.

Some evidence on failing firm/industry motives in conglomerate mergers. Conn, Robert L. Mississippi Valley journal of business and economics, v. 10, no. 2, winter 1974-75: 84-88.

Conglomerate performance measurement - comment - reply. Weston, J.F. and S.K. Mansinghka. Journal of finance, v. 29, no. 3, June 1974: 1011-1015.

Financial characteristics of merging companies - differences between conglomerate and traditional mergers. Hempel, George H, and Ronald L. Melcher. Journal of economics and business, v. 27, no. 1, fall 1974: 17-26.

Toymakers aren't laughing. Financial world, v. 142, no. 24, Dec. 18, 1975: 16-17.

Conglomerate mergers and concentration ratios. Goldberg, L.G. The review of economics and statistics, v. 56, no. 3, Aug. 1974: 303-309A.

Are conlgomerate insurance mergers sui generis? Kamerschen, David R. Journal of risk and insurance, v. 41, no. 3

United States vs. Falstaff Brewing Corporation - potential competition re-examined. Michigan law review, v. 72, no. 4, Mar. 1974: 837-868.

American home is stuck on Wrigley. Business week, n. 2316, Feb. 2, 1974: 23.

Debt Capacity, diversification, and conglomerate mergers. Melnik, A. and M.A. Pollatschek. The journal of finance, v. 28, no. 5: 1263-1273.

Multicompanies. Forbes, v. 113, no.1, Jan. 1, 1974: 166-168.

Is the conglomerates parade over. Kovaly, Kenneth A. Industry week, v. 179, vo. 9, Nov. 26, 1973: 37-41.

The 1968 merger guidelines - do they assist in planning? Smith, David B. and Thomas S. Goho. Managerial planning, v. 22 no. 3, Nov.-Dec. 1973: 6-8.

Gulf tries to solve its profit problems. Business week, no. 2301, Oct. 13, 1973: 110-116.

Cement mergers - market dispersion and conglomerate entry. Hale, Rosemary D. Marquette business review, v. 17, no. 2, July 1973: 98-108.

Conglomerate mergers. Marinelli, Arthur J. American business law journal, v. 11, no. 1, spring 1973: 1-14.

What happens after the acquisition. Nadler, Paul S. Bankers monthly, v, 90, no. 5, May 15, 1973: 11-13.

Conglomerate mergers and the antitrust laws. Blake, Harlan M. Columbia law review, v. 76, no. 3, Mar. 1973: 555-592.

Conglomerate mergers under Section 7 of the Clayton Act. Business lawyer, v. 28: 83-107.

The conglomerate and the hippogriff. Bock, Betty. Conference board record, v. 9, no. 2, Feb. 1972: 6-16.

Can conglomerates survive? McDonald Philip, et. al. California management review, v. 14, no. 2, winter 1971: 61-68.

Conglomeration, and the new American Zaibatsu System II. Antitrust law and economics, v. 4, no. 4, summer 1971: 91-104.

Another demand for Canadian labour autonomy. The labour gazette, v. 71, no. 11, Nov. 1971: 731.

Test of the efficiency performance of conlgomerate firms. Weston, J. Fred. Journal of finance, v. 26, no, 4, Sept. 1971: 919.

Economic Abstracts International

Multi-market interdependence and local market competition in banking. Heggestad, A.A. and S.A. Rhoades. Review of economics and statistics, no. 4, Nov. 1978: 523.

On the theory of conglomerate mergers. Scott, J.H., Jr. Journal of finance, no. 4, Sept. 1977: 1235.

Diversification and the firm's rate of growth. Hassid, J. Manchester school of economic and social studies, no. 1, Mar. 1977: 16.

The failing firm/industry doctrines in conglomerate mergers. Conn, R.L. Journal of industrial economics, no. 3, Mar. 1976: 181.

Performance of conglomerate firms: a portfolio approach. Mason, R. H. and M.B. Goudzwaard. Journal of finance, no. 1, March 1976: 39.

Conglomerate mergers and concentration ratios. Goldberg, L.G. Review of economics and statistics, no. 3, Aug. 1974: 303.

Evidence of the acquisition-related performance of conglomerate firms. Melicher, R.W. and D.F. Rush. Journal of finance, no. 1, Mar. 1974: 141.

The care and feeding of conglomerates. Waddel, W.C. and Zivkovich, P. SAM advanced management journal, no. 1, Jan, 1974: 44.

Conglomerate-building by big businesses. Oriental economist, no. 757, Nov. 1973: 16.

Economic Report; conglomerate merger performance; an empirical analysis of nine corporations. Washington, U.S. Govt. Print. Off., 1972, 135 p.

Conglomerate enterprise and public policy. Markham, J.W. Harvard University Graduate School of Business Administration, Division of Research, 218 p.

sep

APPENDIX RR.—BIBLIOGRAPHY ON PLANT SHUTDOWNS, CLOSURES AND MOVES, COMPILED BY KENNETH ROOT, PH. D.

1979

Public Administration Series: Bibliography

S-79 13360

P-357

November 1979

COMPANIES, MINES AND FACTORIES – SHUTDOWNS, CLOSURES AND MOVES: A Bibliography

Kenneth Root
Luther College
Decorah, Iowa

Vance Bibliographies
Post Office Box 229
Monticello, Illinois 61856

VANCE BIBLIOGRAPHIES Pub. Admin. Series: Bibliography #P 357

COMPANIES, MINES AND FACTORIES -- SHUTDOWNS, CLOSURES AND MOVES: A BIBLIOGRAPHY

by

Kenneth Root
Luther College
Decorah, Iowa, 52101

INTRODUCTION

Over the past 12 years of both researching and consulting on plant closures, I've been aware of the need for a bibliography of research on the moves and shutdowns of companies, mines, and factories. This compilation is my attempt to create such a bibliography. The materials in this document are primarily shutdown studies, although research from the areas of social change, family crisis, and descriptive accounts of agency programs/policy statements where the emphasis has been on closures is also included. The bibliography contains a few foreign items, although the orientation has been on material from the United States. Foreign studies are noted with asteriks preceding the entry. Although pertinent, relevant, and recent research has been the emphasis, there are a number of classic and descriptive pieces going back to the Depression. That literature is extensive, and I have included material from this period, particularly those items which generated a thrust for additional and more recent study.

I suspect that the reader will quickly note that the displacement literature emphasizes blue-collar workers and that relatively few items focus on policy. And it is no surprise to learn that the materials were widely dispersed in economic, psychological, and sociological publications, industrial relations journals, and government agency documents. Additional items were found in medical and law journals as well. The distribution range of these items has plagued me in compiling this bibliography just as it would the resercher/public official/union or company leader interested in their own compilation. Still, I'm hopeful this source will make the task easier for others to do their work.

Thanks to my family for their help, and to Patti Jensen, who started the typing, and to Sur Rothmeyer, who did the lion's share of work in entering the items in the computer.

Special acknowledgement to Dr. Ron Powers and The North Central Regional Center for Rural Development for financial support and encouragement in some of my earlier work should also be noted.

Adamic, Louis. 1931. "Tragic Towns of New England," Harper's Monthly, 162:748-760.

Adams, Leonard P., and Robert L. Aronson. 1957. Workers and Industrial Change: A Case Study of Labor Mobility. Westport, Connecticut: Greenwood Press.

Aiken, Michael, and Louis A. Ferman. 1966. "The Social and Political Reactions to Older Negroes to Unemployment," Phylon, fourth quarter, pp. 333-346.

Aiken, Michael, Louis A. Ferman, and Howard L. Sheppard. 1968. Economic Failure, Alienation and Extremism. Ann Arbor: University of Michigan Press.

*Alexander, K.J.W., and C. L. Jenkins. 1970. Fairfields - A Study of Industrial Change. Allen Lane: Penguin Press.

American Federation of Labor and Congress of Industrial Organizations. 1969. "Adjusting to Automation," Publication No. 144, January. Washington, D.C.

Angell, Robert Cooley. 1936. The Family Encounters the Depression. Gloucester, Massachusetts: Peter Smith.

Anthony, Willis E. 1968. Structural Changes in the Federally Inspected Meat Processing Industry, 1961-1964. United States Department of Agriculture, Agricultural Economic Report, No. 129. Washington, D.C.: U. S. Government Printing Office, February.

Area Development Sites and Facility Planning. 1977. Site Seeking at Former Defense Bases. Available from Director, Economic Adjustment, OSD (MRA & L), Pentagon, Room 3E772, Washington, D.C., 20301, January.

"Are Displaced Worker Plans a Flop?" 1962. Factory, January, p. 75.

*Aris, Stephen. 1963. "Struggles of a Dying Town," New Society, Vol. 1, No. 18, January, pp. 9-10.

Arnold, Sam, and Rose Papier. 1946. After Unemployment What? Columbus, Ohio: The Ohio State University Bureau of Business, Research Monograph No. 39.

Aronson, Elliot. 1965. Unemployment and Retraining: An Annotated Bibliography of Research. U.S. Department of Labor; Manpower Administration, Office of Manpower, Automation and Training, November.

Auman, Fred A. 1962. "Retraining--How Much of an Answer to Technological Unemployment?" Personnel Journal, Vol. 4, November, pp. 505-507.

Ayer, Harry W., and M. Ross Layton. 1972. "Meeting the Economic Impact of Mine-Smelter Phase-Do I in Bisbee-Douglas," Arizona Review. Tucson, Arizona: University of Arizona, Vol. 21, No. 12, pp. 1-5.

Bagdikian, Ben H. 1968. "I'm Out of a Job, I'm All Through," pp. 30-47 in Terrance A. Almquist and Gary R. Blodick, eds., Readings in Contemporary Society. Englewood Cliffs, New Jersey: Prentice-Hall, Inc.

Bain, Trevor. 1968. Defense Manpower and Contract Termination. Division of Economic and Business Research, College of Business and Public Administration. Tucson, Arizona: University of Arizona, September.

Bakke, E. Wight. 19[illegible]0. "The Cycle of Adjustment to Unemployment," pp. 112-125 in Norman W. Bell and Ezra F. Vogel, eds., A Modern Introduction to the Family. Glencoe, Illinois: Free Press.

Bakke, E. Wight. 1940. The Unemployed Worker: A Study of the Effects of Unemployment Upon the Worker's Social Relations and Practices. Shoe String Press, 1969 reprint.

Baron, Richard, ed. 1975. "State Hospitals in Transition: Impact on Staff," Currents, Horizon House Institute, Vol. 2, No. 2, Summer, pp. 1ff.

*Beales, A. L., and R. S. Lambert. 1934. Memoirs of the Unemployed. London: Gollancz.

Becker, Joseph M. 1968. "Private Supplementation of Public Unemployment Benefits," pp. 105-132 in Sar Levitan, Wilbur Cohen, and Robert Lampman, eds., Towards Freedom From Want. Madison, Wisconsin: Industrial Relations Research Association.

Beckman, R. O. 1933. "Mental Perils of Unemployment," Occupations, 12:28-35.

*Belbin, Eunice. 1964. "Retraining the Middle Aged," New Society, Vol. 7, March, pp. 6-8.

*Berglind, Hans. 1977. "Unemployment and Redundancy in a 'Post-Industrial' Labor Market," pp. 195-213 in Marie R. Haug and Jacques Dofny, eds., Work and Technology. Sage Studies in International Sociology, International Sociological Association.

Bernard, Jessie. 1957. Social Problems at Midcentury - Chapter 20: "Problems Associated with Worker Roles at Midcentury". New York: Dryden Press.

Berry, Dale W., and Tracy W. Murray. 1967. "Effects of Mass Layoffs on Local Unemployment Rates," Proceedings of the 20th Annual Winter Meeting, December, Industrial Relations Research Association, Madison, Wisconsin, pp. 356-365.

Bjorklund, Robert L., David Gray, and Max S. Wortman, Jr. 1971. "Project Step-up: A Systems Approach to Upgrading Laid-Off Disadvantaged Workers," Proceedings of the 23rd Annual Winter Meeting, December. Industrial Relations Research Association, Madison, Wisconsin, pp. 286-295.

Blaustein, Saul J. 1958. "Income Maintenance During Unemployment," Marriage and Family Living, 20:221-223.

Bloodworth, Jessie A. 1933. "Social Consequences of Prolonged Unemployment," Employment Stabilization Research Institute, Minneapolis: University of Minnesota, Vol. 2, No. 5, pp. 116-132.

Bloomberg, Warner, Jr., and Victor Hoffman, Jr. 1958. "The Recession Hits Gary, Indiana: Smiling Through?" Commentary, Vol. 26, July, pp. 15-21.

Bradburn, Norman M. 1964. Inter-Plant Transfer: The Sioux City Experience. National Opinion Research Center. Chicago: University of Chicago.

Bradshaw, T. F., and J. L. Scholl. 1976. "Workers on Layoff: A Comparison of Two Data Series," Monthly Labor Review, Vol. 99, No. 11, pp. 29-33.

Braginsky, D. D., and B. M. Braginsky. 1975. "Surplus People: Their Lost Faith in Self and System," Psychology Today, Vol. 9, No. 3, pp. 68-73.

Brandwein, Robert. 1965. "Employment Experience of Discharge: Defense Workers," Monthly Labor Review, 88:1213-1214.

Briar, Katherine H. 1978. The Effect of Long-Term Unemployment on Workers and Their Families. San Francisco: R & E Research Associates.

"Bumps for Hard Core." 1969. Business Week, March 22, p. 41.

Burtt, Everett J., Jr. 1967. Plant Relocation and the Core City Worker: Commuting and Housing Decisions of Relocated Workers, The Boston Experience. Washington, D.C.: U. S. Government Printing Office.

Calkins, Clinch. 1930. Some Folks Won't Work. New York: Harcourt, Brace & Co.

Canan, James W. 1964. "A Second Chance for Ninety Men in Norfolk," The Reporter, Vol. 31, July 16, pp. 34-36.

Cavan, Ruth Shonle. 1959. "Unemployment-Crisis of the Common Man," Marriage and Family Living, Vol. 21, May, pp. 139-146.

Cavan, Ruth Shonle, and Katherine Howland Ranck. 1938. The Family and the Depression. Chicago: University of Chicago Press.

CETA, Office of the Mayor, City of Omaha and the Nebraska Department of Labor, Division of Employment. 1976. A Report on the Development, Administration and Results of the Wilson Organization Re-Employment Committee, Omaha, Nebraska.

Chinitz, Benjamin. 1979. "Economic Dislocation and Public Policy: A Conceptual Framework," paper prepared for the Seminar on Economic Dislocation and Public Policy, National Commission for Employment Policy, Washington, D.C., July 13.

Clague, Ewan. 1961. "Social and Economic Aspects of Automation," Monthly Labor Review, 84:957-960.

Clague, Ewan, Walter Couper, and E. Wight Bakke. 1934. After the Shutdown. New Haven: Institute of Human Relations, Yale University.

Cobb, Sidney, and Stanislav K. Kasl(?). 1972. "Some Medical Aspects of Unemployment," Industrial Gerontology, 12:8-15.

Cobb, Sidney, and Stanislav K. Kasl(?). 1977. Termination: The Consequences of Job Loss. U. S. Department of Health, Education and Welfare, Pub. 77-224.

Cohn, Richard M. 1978. "The Effect of Employment Status Change on Self-Attitudes," Social Psychology, Vol. 41, No. 2, June, pp. 81-93.

✓ Conant, Eaton H. 1965. "Report and Appraisal: The Armour(?) Fund's Sioux City Project," Monthly Labor Review, 88:1297-1302(?).

✓ "Corporations: Swift Tough Cut." 1968. Time, December 6, p. 103.

Creamer, Daniel, and Charles W. Coulter. 1939. "Labor and the Shutdown of the Amoskeag(?) Textile Mills," Studies of the Effects of Industrial Change on Labor Markets, U. S. Works Progress Administration, National Research Project, Report No. L-5, Philadelphia: Works Progress Administration, November.

Darley, J. G., and D. G. Paterson. 1934. Employed and Unemployed Workers: Differential Factors in Unemployment Status. Bulletin of the Employment Stabilization Research Institute, Minneapolis: University of Minnesota Press.

Davis, Rennard. 1961. "Retraining the Unemployed: III. Skill Improvement Training for Electricians and Plumbers," Monthly Labor Review, 84:1074-1080.

Dean, Lois. 1965. "Minersville: A Study in Socioeconomic Stagnation," Human Organization, 24:254-261, Fall.

Dickinson, W. B., Jr. 1962. "Retraining for New Jobs," Editorial Research Reports, II, pp. 775-792.

"Does Aid for the Jobless Create More Jobless?" 1975. Business Week, November 17, p. 142.

Dorsey, John W. 1967. "The Mack Case: A Study in Unemployment," pp. 175-248 in Otto Eckstein, ed., Studies in the Economics of Income Maintenance. Westport, Connecticut: Greenwood Press.

Duncan, Charles W. 1978. "Base Closing: What Impact on Economy," Commander's Digest, Vol. 21, June 1, p. 7.

Eaton, Curtis. 1973. "The Individual and the Defense Mass-Layoff," pp. 179-211 in Bernard Udis, ed., The Economic Consequences of Reduced Military Spending. Lexington, Massachusetts: D. C. Heath.

Eckstein, Otto. 1966. "Perspectives on Employment Under Technical Change," pp. 86-104 in Jack Stieber, ed., Employment Problems of Automation and Advanced Technology: An International Perspective. New York: St. Martin's Press.

"Economic Impacts of Disarmament." 1962. U. S. Arms Control and Disarmament Agency. Washington, D.C., January.

Eisenberg, Philip, and Paul F. Lazarsfeld. 1938. "The Psychological Effects of Unemployment," Psychological Bulletin, Vol. 35, June, pp. 358-390.

Elderton, Marion, ed. 1931. Case Studies of Unemployment. Philadelphia, Pennsylvania: University of Pennsylvania Press.

*Eleen, John W., and Ashley G. Bernardine. 1971. Shutdown: The Impact of Plant Shutdown, Extensive Employment Terminations and Layoffs on the Workers in the Community. Ontario Federation of Labour, CLC: Research Department, August.

"The End of a Company Town." 1971. Life Magazine, March 26, pp. 37-45.

*Evans, Trevor, and Margaret Stewart. 1967. Pathway to Tomorrow: The Impact of Automation on People. Oxford, England: Pergamon Press.

Feldstein, Martin. 1976. "Unemployment Compensation: It's Effect on Unemployment," Monthly Labor Review, Vol. 99, No. 3, pp. 39-41.

Ferman, Louis A. 1963. Death of a Newspaper: The Story of the Detroit Times. Kalamazoo, Michigan: W. E. Upjohn Institute for Employment Research.

Ferman, Louis A. 1964. "Sociological Perspectives in Unemployment Research," pp. 512-523 in Arthur B. Shostak and William Gomberg, eds., Blue-Collar World. Englewood Cliffs, NJ: Prentice-Hall, Inc.

Ferman, Louis A. 1962. "Some Conceptual and Methodological Considerations in the Study of Job Dislocation," Proceedings of the 15th Annual Meeting, December. Industrial Relations Research Association, Madison, Wisconsin, pp. 315-325.

Ferman, Louis A., and Michael Aiken. 1965. "Adjustment of Older Workers to Job Displacement," pp. 493-498 in Arthur B. Shostak and William Gomberg, eds., Blue-Collar World. Englewood Cliffs, NJ: Prentice-Hall, Inc.

Fitzpatrick, Mary Blanche. 1965. Response to Unemployment: Manchester, New Hampshire, 1950-1959. Boston: Federal Reserve Bank Research Report No. 33.

Flanders, Allan. 1966. "The Problems of Consent for Change: The Fawley Refinery Case," pp. 394-411, in Jack Steiber, ed., Employment Problems of Automation and Advanced Technology: An International Perspective. New York: St. Martin's Press.

Fleming, R. W. 1962. "The Problem of the Displaced Worker," Atlanta Economic Review, Vol. 12, March, p. 9.

Fogel, Walter. 1970. The Negro in the Meat Industry. University of Pennsylvania, The Wharton School of Finance and Commerce, Industrial Research Unit. Philadelphia: University of Pennsylvania Press.

Foltman, Felician F. 1968. White and Blue Collars in a Mill Shutdown. Ithaca, NY: Cornell University Press.

Franke, Walter H. 1962. "Labor Market Experiences of Unemployed Older Workers," Proceedings of the 15th Annual Winter Meeting, December, Industrial Relations Research Association, Madison, Wisconsin, pp. 163-175.

Franke, Walter H. 1965. "The Long-Term Unemployed," pp. 42-60 in Joseph W. Becker, ed., in Aid of the Unemployed. Baltimore, MD: Johns Hopkins Press.

Freedman, Audrey. 1968. "Labor Mobility Projects for the Unemployed," Monthly Labor Review, Vol. 91, No. 6, pp. 56-64.

Friedland, William H., Amy E. Barton, and Robert J. Thomas. 1978. Manufacturing Green Gold: The Conditions and Social Consequences of Lettuce Harvest Mechanization. University of California, Davis, College of Agriculture and Environmental Studies, Department of Applied Behavioral Sciences, California Agricultural Policy Seminar.

Garfinkle, Stuart H. 1977. "The Outcome of a Spell of Unemployment," Monthly Labor Review, Vol. 100, No. 1, pp. 54-57.

Gegan, V. F., and S. H. Thompson. 1957. "Worker Mobility in a Labor Surplus Area," Monthly Labor Review, 80:1451-1456.

Gilman, Harry J. 1979. "The Economic Costs of Worker Dislocation: An Overview," paper prepared for the Seminar on Economic Dislocation and Public Policy, National Commission for Employment Policy, Washington, D.C., July 13.

Ginzberg, Eli. 1966. The Development of Human Resources - Chapter 11: "Unemployed Coal Miners," and Chapter 12: "The Great Depression: Living on Relief." New York: McGraw-Hill Book Company.

*Ginzberg, Eli. 1942. Grass on the Slag Heaps: The Story of the Welsh Miners. New York: Harper & Row.

Ginzberg, Eli. 1968. Manpower Agenda for America - Chapter 3: "The Economic Consequences of Automation," and Chapter 9: "The Hidden Costs of Unemployment." New York: McGraw-Hill.

Ginzberg, Eli, Ethel L. Ginsburg, Dorothy L. Lynn, L. Mildred Vickers, and Sol. W. Ginsburg. 1943. The Unemployed. New York: Harper and Row.

Goldberg, Joseph P. 1971. "Seamen and Modernization of Merchant Shipping," Monthly Labor Review, Vol. 94, No. 2, pp. 49-54.

Goodchilds, Jacqueline D., and Ewart E. Smith. 1963. "The Effects of Unemployment as Mediated by Social Status," Sociometry, 26:287-293.

Gordon, Margaret S. 1963. "A Conference on Unemployment," Industrial Relations, Vol. 2, May, pp. 1-6.

Gordon, Margaret S., and Ann H. McCorry. 1957. "Plant Relocation and Job Security: A Case Study," Industrial and Labor Relations Review, Vol. 11, October, pp. 13-36.

Gore, Susan. 1977. "Support Resources for Urban Unemployed," paper presented at the American Sociological Association Meetings, Chicago, Illinois, September 5-9.

Groom, Phyllis P. 1961. "Retraining the Unemployed: I. European Government Programs," Monthly Labor Review, 84:823-828.

Groom, Phyllis P. 1961. "Retraining the Unemployed: II. Federal and State Legislation on Retraining," Monthly Labor Review, 84:939-943.

Hall, O. Milton. 1934. "Attitudes and Unemployment: A Comparison of the Opinions and Attitudes of Employed and Unemployed Men," Archives of Psychology. New York, Vol. 25, No. 165, March, pp. 3-65.

Hart, Joe W. 1964. "Effects of Automation on the Position of Negroes in a Southern Industrial Plant," Journal of Human Relations, Vol. 12, No. 3, pp. 419-421.

Hastings, Robert E. 1970. "In the Wake of a Merger: The Human Trauma--What Happens to the Individual?" Business Horizons, June, pp. 63-70.

Heron, Alastair, and Sheila M. Chown. 1963. "Semi-skilled and Over Forty," pp. 195-207 in Clark Tibbitts and Wilma Donahue, eds., Social and Psychological Aspects of Aging, Vol. 1 of Aging Around the World. New York: Columbia University Press.

*Herron, Frank. 1975. Labour Market in Crisis: Redundancy at Upper Clyde Shipbuilders. New York: Homes & Meier Publishers, Inc.

Hixson, Vivian Scott. 1978. "Disintegrated Lives: The Human Consequences of Unemployment," The Peninsular Papers, Michigan Sociological Association, Vol. 2, No. 2, pp. 62-72.

"...The Impact on People." 1970. Newsweek, May 25, pp. 75-76.

Jacobs, Paul. 1965. "A View from the Other Side: Unemployment as Part of Identity," pp. 45-67 in William G. Bowen and Frederick H. Harbison, eds., Unemployment in a Prosperous Economy. Princeton, NJ: Princeton University Manpower Symposium, Industrial Relations Section, Research Report Series No. 108.

Jacobs, Paul. 1967. "Bringin' Up the Rear," pp. 107-137 in Arthur M. Ross and Herbert Hill, eds., Employment, Race, and Poverty. Harcourt, Brace and World.

Jaffe, A. J., and J. R. Milavsky. 1962. "Unemployment, Retirement, and Pensions," pp. 279-292 in Clark Tibbitts and Wilma Donahue, eds., Social and Psychological Aspects of Aging, Vol. 1 of Aging Around the World. New York: Columbia University Press.

*Jahoda, Marie, Paul F. Lazarsfeld and Hans Zeisel. 1971. Marienthal: The Sociography of an Unemployed Community. Chicago: Aldine Atherton. (First published 1933 as Die Arbeitslosen von Marienthal).

Jick, Todd. 1977. "Coping with Job Loss: An Integration of Research, Application, and Policy Development," Proceedings of the 13th Annual Winter Meeting, December. Industrial Relations Research Association, Madison, Wisconsin, pp. 266-273.

"Job Hunters Face Grimmer Prospects." 1970. Business Week, December 12, pp. 19-20.

Joint Report of Labor Union Study Tour Participants. 1979. Economic Dislocation: Plant Closings, Plant Relocations, and Plant Conversion. Policies and Programs in Three Countries, Recommendations for the U.S., May 1. (International Union, UAW; United Steelworkers of America, and International Association of Machinists.)

*Kahn, H. R. 1964. Repercussions of Redundancy. Allen & Unwin.

Kalish, Carol B. 1966. "Portrait of the Unemployed," Monthly Labor Review, 89:7-14.

Kasl, Stanislav V., Susan Gore and Sidney Cobb. 1975. "The Experience of Losing a Job: Reported Changes in Health, Symptoms, and Illness Behavior," Psychosomatic Medicine, Vol. 37, No. 2, pp. 106-122.

Kellor, Frances A. 1915. Out of Work. New York: G. P. Putnam's Sons. (Arno Reprint: 1971).

Kennedy, Thomas. 1962. Automation Funds and Displaced Workers. Boston: Harvard University.

Kotz, Nick. 1979. "Youngstown's Tragedies: A Legacy for Other Cities," The Washington Post, June 17, pp. B1 & B4. 1

Komarovsky, Mirra. 1940. The Unemployed Man and His Family. New York: Dryden Press. (Arno Reprint: 1971).

Koning, Steven M., and Richard H. Ropers. 1977. "Self Esteem Among the Unemployed," paper presented at the Michigan Sociological Association, Spring Conference, Detroit, Michigan, April 2.

Koos, Earl L. 1950. "Class Differences in Family Reactions to Crisis," Marriage and Family Living, Vol. 12, Summer, pp. 77-78, 99.

Kuptzin, Harold. 1964. "The South Bend Story: The Reemployment Program," Employment Service Review, Vol. 29, March, pp. 37-39.

"Labor, A New Layer of Structural Unemployment." 1977. Business Week, November 14, pp. 142-152.

"Labor's Powerful Bid to Limit Plant Closings." 1979. Business Week, June 25, pp. 1-2.

Layton, M. Ross, and Harry W. Ayer. 1972. The Impacts of Mine Phase-Down and Redevelopment Policies on Local Communities: An Empirical Study, paper presented at the Western Agricultural Economics Association Meetings, Logan, Utah, July 24.

Lebergott, Stanley. 1959. "Long-Term Factors in Labor Mobility and Unemployment," Monthly Labor Review, 82:876-881.

Lebergott, Stanley, ed. 1964. Men Without Work: The Economics of Unemployment. Englewood Cliffs, NJ: Prentice-Hall, Inc.

Levinson, David. 1966. "Displaced Pottery Workers' Adjustment to Layoff," pp. 49-83 in Weathering Layoffs in a Small Community: Case Studies of Displaced Pottery and Carpet-Mill Workers. Department of Labor, Bulletin No. 1516. Washington, D.C.: U. S. Government Printing Office.

Levitan, Sar A., and Harold L. Sheppard. 1963. "Technological Change and the Community," pp. 159-190 in Gerald G. Somers, Edward L. Cushman and Nat Weinberg, eds., Adjusting to Technological Change. New York: Harper & Row.

Lipsky, David B. 1970. "Interplant Transfer and Terminated Workers: A Case Study." Industrial and Labor Relations Review, Vol. 23, No. 2, January, pp. 191-206.

Little, Craig B. 1976. "Technical-Professional Unemployment: Middle-Class Adaptability to Personal Crisis," Sociological Quarterly, 17:262-275.

Locke, Harvey. 1934. "Unemployed Men in Chicago Shelters," Sociology & Social Research, 19:420-428.

Loombe, R. P. 1967. A Study of the Reemployment and Unemployment Experiences of Scientists and Engineers Laid Off from 62 Aerospace and Electronics Firms in the San Francisco Bay Area During 1963-1965. San Jose, California: San Jose State College Center for Interdisciplinary Studies, Manpower Research Group, February.

Lubin, Isador. 1929. "The Absorption of the Unemployed by American Industry," The Brookings Institution Pamphlet Series, Vol. 1, No. 3, Washington, D.C.: The Brookings Institution.

*MacKay, D. K. 1972. "After the Shake-Out," Oxford Economic Papers, March, pp. 89-110.

*MacKay, D. I., and G. L. Reid. 1972. "Redundancy, Unemployment and Manpower Policy," The Economic Journal, December, pp. 1256-1272.

*Mann, Michael. 1973. Workers on the Move: The Sociology of Relocation. Cambridge: University Press.

"Man Out of Work." 1930. Harper's Monthly, 161:195-201.

Martin, William E., Dana Deeds, Edwin Carpenter, Harry Ayer, Louise Arthur, and Russell Gum. 1976. Reduction in Force in a Single Company Town: Who Is Selected and How Do They Adapt? Corvallis, Oregon: Regional Center for Applied Social Science Research, April.

McCarthy, James E. 1975. Trade Adjustment Assistance: A Case Study of the Shoe Industry in Massachusetts. Boston: Federal Reserve Bank Research Report No. 58, June.

Meredith, Jane L. 1961. "Long-Term Unemployment in the United States," Monthly Labor Review (Special Labor Force Report), Vol. 84, No. 6, pp. 601-610.

Miernyk, William H. 1955. Inter-Industry Labor Mobility: The Case of the Displaced Textile Worker. Boston: Northeastern University.

Miernyk, William H. 1957. "The Problem of Depressed Areas," Monthly Labor Review, 80:301-305.

Millen, Bruce H. 1979. "Providing Assistance to Displaced Workers," Monthly Labor Review, Vol. 102, No. 5, pp. 17-22.

Mobility and Worker Adaption to Economic Change in the United States. 1963. Manpower Research Bulletin No. 1. U. S. Department of Labor, Manpower Administration, Office of Manpower Policy, Evaluation and Research. Washington, D.C.: U. S. Government Printing Office.

"More Managers Join the Jobless." 1970. Business Week, May 23, pp. 33-4.

Morgan, Winona L. 1939. The Family Meets the Depression. Minneapolis: University of Minnesota Press.

Myers, Charles A., and George P. Shultz. 1951. The Dynamics of a Labor Market. Westport, Connecticut: Greenwood Press.

Nicolini, Lewis P. 1964. "The South Bend Story: The Shutdown," Employment Service Review, Vol. 29, March, pp. 36, 39.

Northern Natural Gas Company--Area Development Department. 1966. The Livestock Meat Industry in the Omaha-Council Bluffs Metropolitan Area. Northern Natural Gas Company, Omaha, Nebraska.

Norwood, Janet L. 1976. "Some Social Aspects of Unemployment," U. S. Department of Labor Report No. 469.

*Oaklander, Harold. 1978. "The Swiss Call it 'The Firestone Affair'," mimeographed. Available from the Intercollegiate Case Clearing House, Soldiers Field Post Office, Boston, Massachusetts, 02163.

Office of Economic Adjustment. 1977. Economic Adjustment Plan for Tooele County, Utah. Office of the Assistant Secretary of Defense (Installations and Logistics), April.

Office of Economic Adjustment. 1975. Economic Adjustment Program, Carroll County/Jo Daviess County, Illinois. Office of the Assistant Secretary of Defense (Installations and Logistics), December.

Office of Economic Adjustment. 1976. Economic Adjustment Program for Clark and Floyd Counties, Indiana. Office of the Assistant Secretary of Defense (Installations and Logistics), October.

O'Mara, J. Roger. 1965. "Changes in Company Aid to Transferred Homeowners," Conference Board Record, Vol. 2, No. 3, March, pp. 43-46.

O'Mara, J. Roger. 1965. "Real Estate Problems of Relocated Employees," Conference Board Record, Vol. 2, No. 8, August, pp. 33-35.

Padfield, Harland, and William E. Martin. 1965. Farmer, Workers, and Machines. Tucson, Arizona: The University of Arizona Press.

Palen, J. John. 1967. "Radicalism and the Displaced Worker: An Analysis of the Studebaker Shutdown," paper presented at the 1967 meetings of the Midwest Sociological Society.

Palen, J. John, and Frank J. Fahey. 1968. "Unemployment and Reemployment Success: An Analysis of the Studebaker Shutdown," Industrial and Labor Relations Review, Vol. 21, January, pp. 234-250.

Parnes, Herbert S. 1954. Research on Labor Mobility: An Appraisal of Research Findings in the United States. New York: Social Science Research Council.

Perline, M. M. and R. W. Presley. 1973. "Mobility of Unemployed Engineers: A Case Study," Monthly Labor Review, Vol. 96, No. 5, pp. 41-43.

Piore, Michael. 1967. "Negro Workers in the Mississippi Delta: Problems of Displacement and Adjustment," Proceedings of the 20th Annual Winter Meeting, December. Industrial Relations Research Association, Madison, Wisconsin, pp. 366-374.

Powell, Douglas H., and Paul F. Driscoll. 1973. "Middle-Class Professionals Face Unemployment," Society, January/February pp. 18-26.

President's Economic Adjustment Committee. 1978. Acquiring Former Military Bases. Office of Economic Adjustment, Office of the Secretary of Defense, Washington, D.C., (Community Guidance Manual III), October.

President's Economic Adjustment Committee. 1977. Communities in Transition: Community Response to Reduced Defense Activity. Defense Office of Economic Adjustment, Washington, D.C., (Community Guidance Manual 1).

President's Economic Adjustment Committee. 1978. Economic Adjustment Program, Belton, Grandview, Kansas City, Missouri, Vol. 1. Office of Economic Adjustment, Office of the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics), January.

President's Economic Adjustment Committee. 1978. Economic Adjustment Program, Belton, Grandview, Kansas City, Missouri, Vol. 2. Office of Economic Adjustment, Office of the Assistant Secretary of Defense. (Manpower, Reserve Affairs and Logistics).

President's Economic Adjustment Committee. 1978. Economic Adjustment Program, Belton, Grandview, Kansas City, Missouri, Vol. 3. Office of Economic Adjustment, Office of the Assistant Secretary of Defense. (Manpower, Reserve Affairs and Logistics), February.

President's Economic Adjustment Committee. 1979. Economic Adjustment Program, Columbus/Franklin County, Ohio, Vol. 1. Office of Economic Adjustment, Office of the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics), March.

President's Economic Adjustment Committee. 1977. Economic Adjustment Program Report for Big Spring/Howard County, Texas. Office of Economic Adjustment. Office of the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics), August.

President's Economic Adjustment Committee. 1977. Economic Adjustment Program Federal Team Visit—Big Spring/Howard County, Texas. Office of Economic Adjustment, Office of the Assistant Secretary of Defense. (Manpower, Reserve Affairs and Logistics), December.

President's Economic Adjustment Committee. 1976. Economic Adjustment Program (Reconnaisance Report) for Clark and Floyd Counties, Indiana. Office of Economic Adjustment, Office of the Assistant Secretary of Defense. (Installations and Logistics), October.

President's Economic Adjustment Committee. 1975. Economic Recovery: Community Response to Defense Decisions to Close Bases. Defense Office of Economic Assistance, Washington, D.C.

President's Economic Adjustment Committee. 1973. The Impact of Defense Cutbacks on American Communities, July.

President's Economic Adjustment Committee. 1978. Planning Civilian Reuse of Former Military Bases. Office of Economic Adjustment, Office of the Secretary of Defense, Washington, D.C., September.

President's Inter-Agency Economic Adjustment Committee. Opportunities for a Community in Economic Distress. Office of Economic Adjustment.

"Progress Report of Armour's Tripartite Automation Committee." 1961. Monthly Labor Review, 84:851-857.

Pursell, Donald E., and William D. Torrence. 1978. "Age and Reactions to Unemployment: An Empirical Examination of Job Search Methods and Postunemployment Earnings," Proceedings of the Annual Meeting, August. Industrial Relations Research Association, Madison, Wisconsin, pp. 141-148.

Puryear, Mahlon T. 1968. "Technology and the Negro," pp. 197-212 in Louis A. Ferman, Joyce L. Kornbluh, and J. A. Miller, eds., Negroes and Jobs. Ann Arbor: University of Michigan Press.

Rank, John D., and Earl F. Lundgren. 1965. "Easing the Pangs of a Plant Closing," Personnel, 42:67-73.

Raphaelson, Arnold, W. Stanley Devino, and James A. Storer. 1966. A Study of Textile Mill Closings in Selected New England Communities. Orono, Maine: University of Maine, November 10.

Reid, Graham L. 1972. "Job Search and the Effectiveness of Job Finding Methods," Industrial and Labor Relations Review, July, pp. 479-495.

"Retrain to Retain Misplaced Employees." 1960. Factory, Vol. 118, July, pp. 86-89.

Report of the President's Economic Adjustment Committee on Communities Affected by the Defense Facility and Activity Realignments Announced on April 17, 1973. 1973. The Impact of Defense Cutbacks on American Communities. Transmitted to the Congress, July 1973.

Root, Kenneth A. 1970. The Consequences of Displacement: Anomia and Deviant Behavior, Ph.D. Dissertation, University of Iowa.

Root, Kenneth A. 1978. "Job Loss and Job Losers: Variability in Response to Displacement," paper presented at the Annual Meeting of the Society for the Study of Social Problems: Labor Studies Division, San Francisco, California, September 1-4.

Root, Kenneth A. 1977. "Workers and Their Families in a Plant Shutdown," paper presented at the American Sociological Association Meetings, Chicago, Illinois, September 5-9.

Root, Kenneth, and Roger Mayland. 1978. "The Plant's Closings, What Are We Going to Do?: Worker and Family Response to Job Displacement," paper presented at the Annual Meeting of the National Council on Family Relations: Family Action Session, Philadelphia, PA, October 19-22.

Root, Kenneth A., and John P. Zipay. 1968. Unemployment in Omaha In Relation to the Armour Closing. Omaha, Nebraska: University of Nebraska at Omaha, Urban Studies Center.

Rose, Arnold M. 1964. "The New Problem of Large-Scale Unemployability," The American Journal of Economics and Sociology, Vol. 23, No. 4, October, pp. 337-350.

Ross, David Phillips. 1967. "The Economics of Privately Negotiated Technological Change Provisions," Proceedings of the 20th Annual Winter Meeting, December. Industrial Relations Research Association, Madison, Wisconsin, pp. 375-384.

Rothstein, Edward. 1953. "Plant Relocation and Discarded Workers," Social Problems, 1:28-31.

Rottenberg, Stanley H. 1959. "Labor's Aims in Adjusting to the New Technology: Economic and Social Implications," paper presented at the Conference on Labor and Science in a Changing World, Industrial Union Department of the AFL-CIO, Washington, D.C., January 7-8, printed in the Monthly Labor Review, 82:164-165.

Sandman, Jean. 1977. AID Center: Second Annual Services Report, January 1, 1976-December 31, 1976. Sioux City, Iowa: AID Center, 722 Nebraska Street.

Schervish, Paul G. 1978. "A Theory of the Social Relations of Unemployment," The Peninsular Papers, Michigan Sociological Association, Vol. 2, No. 2, pp. 1-17.

Schriver, William R., Roger L. Bowlby, and Donald E. Pursell. 1976. "Evaluation of Trade Readjustment Assistance to Workers: A Case Study." Social Science Quarterly, Vol. 57, No. 3, December.

Sheehan, William J. 1978. "EAC Helps Community Help Self," Commanders Digest, Vol. 21, No. 8, p. 8.

Sheppard, Harold L. 1971. New Perspectives on Older Workers. W. E. Upjohn Institute for Employment Research, Kalamazoo, Michigan.

Sheppard, Harold L., and Harvey A. Belitsky. 1966. The Job Hunt. Baltimore, Maryland: The Johns Hopkins Press.

Sheppard, Harold L., and A. Harvey Belitsky. 1968. Promoting Jobfinding Success for the Unemployed. W. E. Upjohn Institute for Employment Research, Kalamazoo, Michigan, April.

Sheppard, Harold L., and James L. Stern. 1957. "Impact of Automation on Workers in Supplier Plants," Labor Law Journal, 8:714-718.

Sheppard, Harold, Louis A. Ferman, and Seymour Faber. 1959. Too Old to Work--Too Young to Retire: A Case Study of a Permanent Plant Shutdown. Detroit: Institute of Labor and Industrial Relations, University of Michigan and Wayne State University.

Shiskin, Julius. 1975. "Unemployment: Measurement, Problems and Recent Trends," U. S. Department of Labor, Bureau of Labor Statistics Report No. 445.

Shultz, George P., and Arnold R. Weber. 1964. "The Fort Worth Project of the Armour Automation Committee," Monthly Labor Review, Vol. 87, No. 1, pp. 53-57.

Shultz, George P., and Arnold R. Weber. 1966. Strategies for the Displaced Worker. New York: Harper & Row.

Singer, James W. 1979. "A Radical Solution to the Problem of Runaway Plants," National Journal, June 23, pp. 1040-1043.

Slocum, Flora, and Charlotte Ring. 1934-35. "Industry's Discarded Workers: A Study of 100 St. Louis Relief Families," Sociology and Social Research, 19:520-526.

Slote, Alfred. 1969. Termination: The Closing at Baker Plant. New York: The Bobbs-Merrill Company.

Smith, Dowell H. 1977. "An Independent Evaluation of the Title IX Analysis of the Corning Closing," Albion, Michigan, mimeographed.

Smith, Luke M., and Irving A. Fowler. 1964. "Plant Relocation and Worker Migration," pp. 499-505 in Arthur B. Shostak and William Gomberg, eds., Blue-Collar World. Englewood Cliffs, NY: Prentice-Hall, Inc.

Smith, Robert P. 1965. "The Impact of Mass Layoffs: July 1963-June 1965," Proceedings of the 18th Annual Winter Meeting, December. Industrial Relations Research Association, Madison, Wisconsin, pp. 204-219.

Snyder, Russell A. 1968. What to Expect in Omaha: A Review of the State of the Art on Technological Displacement in Armour and Company and Criteria of Success for the 1968 Closing in Omaha, Nebraska. University of Nebraska at Omaha, Urban Studies Center, Omaha, Nebraska.

Sobel, Irvin, and Richard C. Wilcock. 1963. "Job Placement Services for Older Workers in the United States," International Labour Review, Vol. 88, August, pp. 129-156.

"The Social Costs of Automation." 1969. Business Week, May 3, p. 98.

Solie, Richard J. 1968. "Employment Effects of Retraining the Unemployed," Industrial and Labor Relations Review, 21:210-225.

Somers, Gerald. 1958. "Labor Recruitment in a Rural Depressed Area," Monthly Labor Review, 81:1113-1120.

Somers, Gerald, ed. 1968. Retraining the Unemployed. Madison: The University of Wisconsin Press.

"Springfield, Massachusetts. Armory Closing." 1968. Time Magazine, May 10, pp. 111-112.

Stein, Robert L. 1963. "Work History, Attitudes and Income of the Unemployed," Monthly Labor Review, 86:1405-1413.

Stern, James L. 1971. "Consequences of Plant Closure," The Journal of Human Resources, Vol. 7, No. 1, pp. 3-25.

Stern, James L. 1969. "Improved Manpower Planning in Armour Plant Closings from Oklahoma City in 1960 to Omaha in 1968," The Industrial Relations Research Institute, Madison, Wisconsin: University of Wisconsin.

Stern, James L., Kenneth A. Root, and Stephen M. Hills. 1974. "The Influence of Social-Psychological Traits and Job Search Patterns on the Earnings of Workers Affected by a Plant Closure," Industrial and Labor Relations Review, 28:103-121.

Stevens, Joe B., William W. Pierson, and David E. Ervin. 1975. On the Process and Consequences of Job Rationing in Oregon's Declining Wood Products Industry. Western Rural Development Center, Discussion Paper No. 4, Corvallis, Oregon: Oregon State University.

Stoikov, Vladimir. 1969. "The Allocation of the Cost of Displaced Labor and Severance Pay," Journal of Human Resources, Vol. 4, No. 2, pp. 192-204.

Stouffer, Samuel A., and Paul F. Lazarsfeld. 1937. Research Memorandum on the Family in the Depression. New York: Social Science Research Council, Bulletin 29. (Arno Reprint: 1972).

Strange, Walter. 1978. "Job Loss: A Psychosocial Study of Worker Reactions to a Plant-Closing in a Company Town in Southern Appalachia." Cornell University, Ph.D. Dissertation.

Sutherland, Edwin H., and Harvey J. Locke. 1936. Twenty Thousand Homeless Men. Chicago: J. B. Lippincott Co. (Arno Reprint: 1971).

Tiffany, Donald W., James R. Cowan, and Phyllis M. Tiffany. 1970. The Unemployed: A Social-Psychological Portrait. Englewood Cliffs, NJ: Prentice-Hall, Inc.

Tolles, N. Arnold. 1966. "The Post-Layoff Experience of Displaced Carpet-Mill Workers," pp. v-47 in Weathering Layoffs in a Small Community: Case Studies of Displaced Pottery and Carpet-Mill Workers. Department of Labor, Bulletin No. 1516, Washington, D.C.: U. S. Government Printing Office.

Udis, Bernard. 1973. The Economic Consequences of Reduced Military Spending. Lexington, Massachusetts: D. C. Heath & Co.

"Unemployment in America." 1963. Newsweek, Vol. 61, April 1, pp. 58-71.

United States Department of Defense. 1977. Economic Adjustment for Defense Impacted Communities (Community Adjustment Manual, Draft). Washington, D.C.

United States Department of Labor. 1964. "Case Studies of Displaced Workers." Bulletin No. 1408. Washington, D.C.: U. S. Government Printing Office.

United States Department of Labor. 1960. "Impact of Workers and Community of a Plant Shutdown in a Depressed Area," Bulletin No. 1264. Washington, D.C.: U. S. Government Printing Office.

United States Department of Labor. 1966. The Operation of Severance Pay Plans and Their Implications for Labor Mobility. Bulletin No. 1462. Washington, D.C.: U. S. Government Printing Office.

United States Department of Labor. 1969. Plant Movement, Transfer and Relocation Allowances: Major Collective Bargaining Agreements. Bulletin No. 1425-10. Washington, D.C.: U. S. Government Printing Office.

United States Department of Labor. 1965. Severance Pay and Layoff Benefit Plans: Major Collective Bargaining Agreements. Bulletin No. 1425-2. Washington, D.C.: U. S. Government Printing Office.

United States Department of Labor. 1965. Unemployment and Retraining: An Annotated Bibliography of Research. Office of Manpower, Automation and Training. Washington, D.C.: U. S. Government Printing Office.

United States Employment Service. 1966. "The Impact of Technological Change in the Meatpacking Industry." March. Washington, D.C.: U. S. Government Printing Office.

"The Utica Story: Matching Workers to Jobs." 1954. Industrial Bulletin, April, pp. 3-7.

Vietorisz, Thomas, Robert Mier, Bennett Harrison, and Jean-Ellen Giblin. 1974. "Subemployment: Concepts, Measurements, and Trends," Proceedings of the 27th Annual Winter Meeting, December, Industrial Relations Research Association, Madison, Wisconsin, pp. 117-128.

Voydanoff, Patricia. 1977. "Unemployment and the Family," paper presented at the meeting of the National Council on Family Relations, October.

Weber, Arnold R. 1963. "The Interplant Transfer of Displaced Employees," pp. 95-143 in Gerald Somers, Edward L. Cushman and Nat Weinberg, eds., Adjusting to Technological Change. New York: Harper & Row.

Weber, Arnold R. 1963. "Plant Removals and Subcontracting of Work: Social and Economic Considerations," Labor Law Journal, 14:373-379.

Weber, Arnold R. 1963. Retraining the Unemployed. Chicago: The University of Chicago Graduate School of Business, Selected Papers No. 4.

Weber, Arnold, and David P. Taylor. 1963. "Procedures for Employee Displacement: Advance Notice of Plant Shutdown," Journal of Business, July, pp. 302-315.

*Wedderburn, D. 1965. Redundancy and the Railwaymen. London: Cambridge University Press.

*Wedderburn, D. 1964. White Collar Redundancy. London: Cambridge University Press.

"When Factories Shut Down." 1979. Transaction (new Society), Vol. 8, No. 3, p. 14.

White, John P. 1978. "DoD Provides Assistance to Impacted Areas," Commanders Digest, Vol. 21, No. 8, pp. 3-7.

Whitman, Edmund S., and W. James Schmidt. 1966. Plant Relocation: A Case History of a Move. New York: American Management Association.

Wilcock, Richard C. 1957. "Employment Effects of a Plant Shutdown in a Depressed Area," Monthly Labor Review, 80:1047-1052.

Wilcock, Richard C. 1960. Impact on Workers and Community of a Plant Shutdown in a Depressed Area. U. S. Department of Labor, Bulletin No. 1264, June.

Wilcock, Richard C. 1965. "Who Are the Unemployed?" pp. 25-41 in Joseph M. Becker, ed., in Aid of the Unemployed. Baltimore, MD: Johns Hopkins Press.

Wilcock, Richard C., and Walter H. Franke. 1961. Oklahoma City Survey of Former Armour Workers, 1960-1961: Impact of the Plant Shutdown on Unemployment, Jobs, and Economic Status. Unpublished mimeographed manuscript submitted to the Armour Automation Fund Committee, June 26.

Wilcock, Richard C., and Walter H. Franke. 1962. 1962 Resurvey of Former Armour and ABC Workers. Unpublished mimeographed manuscript prepared for the Armour Automation Committee, Governor's Committee on Unemployment (Illinois), and U. S. Bureau of Employment Security, July.

Wilcock, Richard C., and Walter H. Franke. 1961. Three City Survey of Former Armour Workers, 1960: Impact of Plant Shutdowns on Unemployment, Jobs, and Economic Status, unpublished mimeographed manuscript submitted to the Armour Automation Fund Committee, January 1961, with minor revisions in August 1961.

Wilcock, Richard C., and Walter H. Franke. 1963. Unwanted Workers. Collier-Macmillan Ltd. London: The Free Press of Glencoe.

Williams, James M. 1933. Human Aspects of Unemployment and Relief. Chapel Hill: University of North Carolina Press.

Wisconsin State Employment Service. 1960. LaCrosse Reemployment Study, LaCrosse, Wisconsin: Wisconsin State Employment Service.

Woolston, Howard B. 1934-35. "The Psychology of Unemployment," Sociology and Social Research, 19:335-340.

Worthy, Ward. 1972. "Saltville Rallies After Olin Shutdown," Chemical and Engineering News, March 13, pp. 7-9.

Wright, Helen Russell. 1934. "The Families of the Unemployed in Chicago," Social Service Review, 8:17-30.

Wunderlich, Frieda. 1934. "New Aspects of Unemployment in Germany," Social Research, 1:97-110.

Young, Edwin. 1963. "The Armour Experience: A Case Study of a Plant Shutdown," pp. 144-159 in Gerald G. Somers, Edward L. Cushman and Nat Weinberg, eds., Adjusting to Technological Change. New York: Harper and Row.

Zawadzki, Bowen, and Paul Larzarsfeld. 1935. "The Psychological Consequences of Unemployment," Journal of Social Psychology, 6:224-251.

Zeisel, Joseph. 1964. "A Profile of Unemployment," pp. 115-129 in Stanley Lebergott(?), ed., Men Without Work: The Economics of Unemployment. Englewood Cliffs, NJ: Prentice-Hall, Inc.

best copy available